In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

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3/26/73	Answer of deft. #2 to complaint. 3/m 3/26.
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8/3/73	MOTIONS to dismiss on issues of Investors Co. Act 22(d), 22(f) jurisdiction argued and taken under advisement. (Rep: Doyne Spencer) Corcoran, J.
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12/14/73	MEMORANDUM OPINION. (N) (Filed in CA 2454-72)
2/11/74	NOTICE of Appeal by pltf. to the Supreme Court of the U.S. from Judgment of 12/14/74; c/m 2/11/74.

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UNITED STATES DISTRICT COURT

DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, PLAINTIFF, v. THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.; MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.; FIDELITY FUND, INC.; WELLINGTON FUND, INC.; THE CROSBY CORPORATION; VANCE, SANDERS & COMPANY, INC.; THE WELLINGTON MANAGEMENT COMPANY, INC.; MERRILL LYNCH, PIERCE FENNER & SMITH, INC.; BACHE & COMPANY, INC.; REYNOLDS SECURITIES CORPORATION; F. I. DUPONT, GLORE FORGAN, INC.; E. F. HUTTON, INC.; WALSTON & COMPANY, INC.; DEAN WITTER & COMPANY, INC.; PAINE, WEBBER, JACKSON & CURTIS, INC.; HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., DEFENDANTS.	Civil Action No. 338-73 Filed: Feb. 21, 1973 Antitrust Equitable Relief Sought

COMPLAINT

The United States of America, plaintiff, by its attorneys, acting under the direction of the Attorney General of the United States, brings this civil action against the above-named defendants, and complains and alleges as follows:

I

Jurisdiction and Venue

1. This complaint is filed and this action is instituted under Section 4 of the Act of Congress of July 2, 1890 (15 U.S.C. § 4), as amended, entitled "An Act to protect trade and commerce against unlawful restraints and monopolies," commonly known as the Sherman Act, in order to prevent and restrain continuing violations by the defendants, as hereinafter alleged, of Section 1 of the Sherman Act.

2. Each of the defendants in each of the Counts hereinafter alleged, except Fidelity Fund, Inc., Massachusetts Investors Growth Stock Fund, Inc., and Wellington Fund, Inc., transacts business or is found within the District of Columbia.

II

Definitions

3. As used herein:

(a) "mutual fund" means an open-end management investment company as that term is defined in the Investment Company Act of 1940 (15 U.S.C. § 80a-(3), (4), and (5));

(b) "principal underwriter" means a principal underwriter of a mutual fund as that term is defined in the Investment Company Act of 1940 (15 U.S.C. § 80a-2(29);

(c) "broker/dealer" means a securities broker/dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. § 78o);

(d) "brokerage transaction" means a securities transaction executed by a broker/dealer as agent for the account of others;

(e) "dealer transaction" means a securities transaction executed by a broker/dealer as principal for its own account;

(f) "primary distribution system" means the purchase of mutual fund shares by an investor through (1) a broker/dealer which has a sales agreement with the principal underwriter, (2) the principal underwriter, and (3) the mutual fund;

(g) "secondary dealer market" means an interdealer market in mutual fund shares and a market in which any dealer can purchase mutual fund shares from investors at more than the redemption price; and

(h) "brokerage market" means the transfer, by means of a brokerage transaction, of already issued and outstanding mutual fund shares between investors, acting through broker/dealers.

Count I

I

Defendants

4. The Crosby Corporation (hereinafter "Crosby"), a corporation organized under the laws of the State of Delaware and having its principal place of business in Boston, Massachusetts is made a defendant herein. Crosby is the principal underwriter of the following mutual funds, hereinafter collectively called the Fidelity Funds:

Everest Fund, Inc.
Fidelity Trend Fund, Inc.
Fidelity Capital Fund, Inc.
Fidelity Fund, Inc.
Essex Fund, Inc.
Salem Fund, Inc.
Puritan Fund, Inc.
Fidelity Bond Debenture Fund

The Fidelity Funds have combined net assets in excess of $3.4 billion.

5. Vance, Sanders & Company (hereinafter "Vance, Sanders"), a corporation organized under the laws of the State of Maryland and having its principal place of business in Boston, Massachusetts, is made a defendant herein. Vance, Sanders is the principal underwriter of the following mutual funds, hereinafter collectively called the Vance, Sanders Funds:

Vance, Sanders Special Fund
Massachusetts Investors Growth Stock Fund
Massachusetts Investors Trust
Century Shares Trust
Boston Common Stock Fund
Boston Fund
Massachusetts Income Development
Massachusetts Capital Development Fund
Massachusetts Financial Development Fund

The Vance, Sanders Funds have combined net assets in excess of $3.7 billion.

6. The Wellington Management Company (hereinafter "Wellington"), a corporation organized under the laws of the State of Delaware and having its principal place of business in Philadelphia, Pennsylvania, is made a defendant herein. Wellington is the principal underwriter of the following mutual funds, hereinafter collectively called the Wellington Funds:

W. L. Morgan Growth Fund, Inc.
Explorer Fund, Inc.
Ivest Fund, Inc.
Trustees Equity Fund, Inc.
Windsor Fund, Inc.
Wellington Fund, Inc.
Wellesley Income Fund

The Wellington Funds have combined net assets in excess of $2.2 billion.

7. The following broker/dealers, each of which is a corporation, and which hereinafter are called collectively "defendant broker/dealers," are made defendants herein:

Broker/Dealer	Principal Office
Merrill Lynch, Pierce Fenner & Smith, Inc.	New York, New York
Bache & Company, Inc.	New York, New York
Reynolds Securities Corporation	New York, New York
F. I. duPont, Glore Forgan, Inc.	New York, New York
E. F. Hutton, Inc.	New York, New York
Walston & Company, Inc.	New York, New York
Dean Witter & Company, Inc.	San Francisco, California

Broker/Dealer	Principal Office
Paine, Webber, Jackson & Curtis, Inc.	New York, New York
Hornblower & Weeks-Hemphill, Noyes, Inc.	New York, New York

8. The National Association of Securities Dealers, Inc. (hereinafter "NASD"), an incorporated association of broker/dealers registered under the Securities Exchange Act of 1934 (15 U.S.C. 78o-3), and having its principal place of business in Washington, District of Columbia, is made a defendant herein. More than 4400 broker/dealers and principal underwriters are members of the NASD. Each of defendant principal underwriters and defendant broker/dealers is a member of the NASD.

II

Trade and Commerce

9. Mutual funds are investment management companies which invest in securities of other corporations and issue shares representing interests in the assets of the mutual fund. Shares of the mutual fund are continuously issued and redeemed by the mutual fund. Numerous mutual funds distribute their shares through a principal underwriter which generally has the exclusive contractual right to distribute shares of the mutual fund. Many principal underwriters enter into sales agreements with broker/dealers which then sell the mutual fund shares to investors. Shares are usually redeemed either through the primary distribution system or are sent directly to the mutual fund or an agent of the fund for repurchase or redemption. Mutual funds are required by law to redeem their shares on demand. There is a constant flow of the purchase, sale, and redemption of mutual fund shares in interstate commerce distributed by principal underwriters, including defendant principal underwriters, and sold to investors by broker/dealers, including defendant broker/dealers. More than 2100 broker/dealer and principal underwriter members of defendant NASD throughout the United States distribute mutual fund shares.

10. During 1971 shares of mutual funds valued at more than $5.1 billion were sold in the United States and mutual fund shares valued at more than $5.0 billion were redeemed.

From 1940 to 1971 the total assets of mutual funds in the United States increased from less than $1 billion to more than $55 billion and the number of mutual fund shareholder accounts increased from 300,000 to nearly 11 million. As estimated 8.5 million individuals and more than 260,000 institutions, such as pension and profit sharing funds, colleges, churches, hospitals, and social and labor organizations, own mutual fund shares. Individual mutual fund investors tend to be small investors, the average mutual fund transaction amounting to $2,900.

11. Mutual fund shares are sold at a public offering price described in the mutual fund prospectus which is based on the net asset value of the fund plus a sales load (commission). The sales load, in most cases, is 7½ percent-8½ percent of the offering price, depending upon the amount of the purchase and the rates set by the individual mutual fund. Lower rates usually apply on larger purchases. Mutual funds generally redeem their outstanding shares at their current net asset value.

12. When a mutual fund share is sold the principal underwriter retains a portion of the sales load, generally 1-1½ percent and the broker/dealer retains the remainder. During 1971, approximately $240 million in mutual fund sales loads were charged to investors in the United States. During 1970, sales load charges on mutual fund shares distributed by defendant principal underwriters amounted to more than $32 million, of which defendant broker/dealers received in excess of $8 million.

13. Section 22(d) of the Investment Company Act of 1940 (15 U.S.C. § 80a-22(d)) provides that a broker/dealer engaged in a dealer transaction in mutual fund shares must sell the mutual fund share at the current public offering price described in the prospectus unless the sale is to another dealer, the principal underwriter or the mutual fund.

14. A broker/dealer is authorized by the securities laws to engage in both brokerage transactions and dealer transactions. Section 22(d) of the Investment Company Act of 1940 applies only to dealer transactions. Thus, when a broker/dealer executes a brokerage transaction between two investors, or when two broker/dealers, one acting for the purchasing investor and one acting for the selling investor, execute a brokerage transaction in mutual fund

shares, the public offering price need not be maintained. In such a situation the broker/dealer is not prohibited by the Investment Company Act from independently establishing the commission for the transaction.

III

Violation Alleged

15. For many years, up to and including the date of filing of this complaint, defendant NASD and the members of defendant NASD, including defendant broker/dealers and defendant principal underwriters, have entered into and maintained a combination and conspiracy among themselves in restraint of the aforesaid trade and commerce in the purchase and sale of mutual fund shares in violation of Section 1 of the Sherman Act.

16. The aforesaid combination and conspiracy has consisted of a continuing understanding and concert of action, the substantial terms of which have been, and are, to prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares.

17. In effectuating said combination and conspiracy NASD and the members of the NASD have done the following things, among others:

(a) established and maintained rules which inhibited the development of a secondary dealer market and a brokerage market in mutual fund shares;

(b) established and maintained rules which induced broker/dealers to enter into sales agreements with principal underwriters, with knowledge that sales agreements contained restrictive provisions which inhibited the development of a secondary dealer market and brokerage market in mutual fund shares;

(c) induced member principal underwriters to include restrictive provisions in their sales agreements;

(d) discouraged persons who made inquiry about the legality of a brokerage market from participating in a brokerage market and distributed misleading information to its members concerning the legality of a brokerage market in mutual fund shares; and

(e) suppressed market quotations for the secondary dealer market.

18. The unlawful combination and conspiracy hereinbefore alleged has had the following effects, among others:

(a) sales of mutual fund shares have been confined to a primary distribution system and the growth and development of a secondary dealer market and a brokerage market in mutual fund shares has been inhibited; and

(b) the public has been deprived of the benefits of free and open competition in a secondary dealer market and a brokerage market in mutual fund shares.

Count II

I

Defendants

19. Crosby, as described in paragraph 4 hereof, is made a defendant herein.

20. Each of defendant broker/dealers, as described in paragraph 7 hereof, is made a defendant herein.

II

Trade and Commerce

21. Paragraphs 9 through 14 hereof are realleged in full.

III

Violation Alleged

22. For many years up to and including the date of the filing of this complaint, defendant Crosby has entered intc and maintained contracts, and combinations with each defendant broker/dealer, and other broker/dealers, in unreasonable restraint of the aforesaid trade and commerce in the purchase and sale of mutual fund shares in violation of Section 1 of the Sherman Act.

23. The aforesaid contracts and combinations have consisted of continuing understandings and agreements, the substantial terms of which have been, and are, that:

(a) each broker/dealer must maintain the public offering price in any brokerage transaction in which it participates involving the purchase or sale of shares of the Fidelity Funds; and

(b) each broker/dealer must sell shares of the Fidelity

Funds only to investors or the fund and purchase such shares only from investors or the fund.

24. The effects of the aforesaid unlawful contracts and combinations have been, and are, among others, that:

(a) the price of brokerage transactions in shares of the Fidelity Funds has been fixed and maintained at artificial and noncompetitive levels;

(b) the purchase and sale of shares of the Fidelity Funds has been confined to a primary distribution system and the growth and development of a secondary dealer market and a brokerage market in the purchase and sale of such shares has been inhibited;

(c) the public has been deprived of the benefits of free and open competition in the purchase and sale of shares of the Fidelity Funds by means of brokerage transactions; and

(d) broker/dealers with whom Crosby does not have sales agreements have been deprived of opportunities to purchase and sell shares of the Fidelity Funds.

Count III

I

Defendants

25. Fidelity Fund, Inc., a mutual fund organized under the laws of the State of Massachusetts, is made a defendant herein. Fidelity Fund, Inc., has net assets of $1.86 billion and in 1970 issues shares having a value of $40 million.

26. Crosby, as described in paragraph 4 hereof, is made a defendant herein.

II

Trade and Commerce

27. Paragraphs 9 through 14 hereof are realleged in full.

III

Violation Alleged

28. For many years up to and including the date of the filing of this complaint, defendant Crosby has entered into and maintained contracts and combinations with each of the

Fidelity Funds, including defendant Fidelity Fund, Inc., in unreasonable restraint of the aforesaid trade and commerce in mutual fund shares in violation of Section 1 of the Sherman Act.

29. The aforesaid contracts and combinations have consisted of continuing understandings and agreements, the substantial terms of which have been and are, that the dealer agreements entered into between Crosby and broker/dealers would contain the restrictions set forth in paragraph 23(a) and 23(b) hereof.

30. The effects of the aforesaid unlawful contracts and combinations have been and are, among others, that:

(a) the price of brokerage transactions in shares of the Fidelity Funds has been fixed and maintained at artificial and noncompetitive levels;

(b) the purchase and sale of shares of the Fidelity Funds has been confined to a primary distribution system and the growth and development of a secondary dealer market and a brokerage market in the purchase and sale of such shares has been inhibited;

(c) the public has been deprived of the benefits of free and open competition in the purchase and sale of shares of the Fidelity Funds by means of brokerage transactions; and

(d) broker/dealers with whom Crosby does not have sales agreements have been deprived of opportunities to purchase and sell shares of the Fidelity Funds.

Count IV

I

Defendants

31. Vance, Sanders, as described in paragraph 5 hereof, is made a defendant herein.

32. Each of defendant broker/dealers, as described in paragraph 7 hereof, is made a defendant herein.

II

Trade and Commerce

33. Paragraphs 9 through 14 hereof are realleged in full.

III

Violation Alleged

34. For many years, up to and including the date of the filing of this complaint, defendant Vance, Sanders has entered into and maintained contracts and combinations with each defendant broker/dealer, and other broker/dealers, in unreasonable restraint of the aforesaid trade and commerce in the purchase and sale of mutual fund shares in violation of Section 1 of the Sherman Act.

35. The aforesaid contracts and combinations have consisted of continuing understandings and agreements, the substantial terms of which have been and are, that:

(a) in all sales of shares of the Vance, Sanders Funds to the public, the broker/dealer would act as dealer for its own account; and

(b) the broker/dealer would not purchase shares of Vance, Sanders Funds from other broker/dealers and would not sell such shares to other broker/dealers, or, in the alternative, would sell such shares to other broker/dealers only at the public offering price.

36. The effects of the aforesaid unlawful contracts and combinations have been and are, among others, that:

(a) the purchase and sale of Vance, Sanders Funds has been confined to a primary distribution system and the public has been deprived of the benefits of a secondary dealer market and a brokerage market in the purchase and sale of shares of the Vance, Sanders Funds; and

(b) broker/dealers with whom Vance, Sanders does not have sales agreements have been deprived of opportunities to purchase shares of the Vance, Sanders Funds, or, in the alternative, to purchase and sell shares of the Vance, Sanders Funds at competitive prices.

Count V

I

Defendants

37. Massachusetts Investors Growth Stock Fund ("MIG Fund"), a mutual fund organized under the laws of the State of Massachusetts, is made a defendant herein. MIG

Fund has net assets in excess of $1.2 billion and in 1970 issued shares having a value of $62 million.

38. Vance, Sanders, as described in paragraph 5 hereof, is made a defendant herein.

II

TRADE AND COMMERCE

39. Paragraphs 9 through 14 hereof are realleged in full.

III

VIOLATION ALLEGED

40. For many years, up to and including the date of the filing of this complaint, Vance, Sanders has entered into and maintained contracts and combinations with each of the Vance, Sanders Funds, including defendant MIG Fund, in unreasonable restraint of the aforesaid trade and commerce in the purchase and sale of mutual fund shares in violation of Section 1 of the Sherman Act.

41. The aforesaid contracts and combinations have consisted of a continuing understanding and agreement, the substantial terms of which have been and are, that in all sales of shares of the Vance, Sanders Funds to the public, Vance, Sanders would act as principal for its own account.

42. The effects of the aforesaid combinations and conspiracies have been and are, among others, that Vance, Sanders is prohibited from executing brokerage transactions in shares of the Vance, Sanders Funds, thereby depriving investors of a brokerage market in such shares.

COUNT VI

I

DEFENDANTS

43. Wellington, as described in paragraph 6 hereof, is made a defendant herein.

44. Each of defendant broker/dealers, as described in paragraph 7 hereof, is made a defendant herein.

II

TRADE AND COMMERCE

45. Paragraphs 9 through 14 hereof are realleged in full.

III

Violation Alleged

46. For many years up to and including the date of the filing of this complaint, Wellington has entered into and maintained contracts and combinations with each defendant broker/dealer, and other broker/dealers, in unreasonable restraint of the aforesaid trade and commerce in mutual fund shares in violation of Section 1 of the Sherman Act.

47. The aforesaid unlawful contracts and combinations have consisted of continuing agreements and understandings, the substantial terms of which have been and are, that:

(a) the broker/dealer must sell shares of the Wellington Funds only as principal, for its own account;

(b) the broker/dealer must not purchase shares of the Wellington Funds from other broker/dealers and must not sell such shares to other broker/dealers; and

(c) in all transactions involving Wellington and the broker/dealer, Wellington would act only as agent for the appropriate Wellington Fund.

48. The effects of the aforesaid unlawful contracts and combinations have been and are, among others, that:

(a) the purchase and sale of Wellington Funds has been confined to a primary distribution system and the public has been deprived of a secondary dealer market and a brokerage market in the purchase and sale of shares of the Wellington Fund; and

(b) broker/dealers with whom Wellington did not have sales agreements have been deprived of opportunities to purchase and sell shares of the Wellington Funds.

Count VII

I

Defendants

49. Wellington Fund, Inc., a mutual fund organized under the laws of the State of Delaware, is made a defendant herein. Wellington Fund, Inc., has assets in excess of $1.2 billion, and in 1971 issued shares having a value in excess of $33 million.

50. Wellington, as described in paragraph 6 hereof, is made a defendant herein.

II

Trade and Commerce

51. Paragraphs 9 through 14 hereof are realleged in full.

III

Violation Alleged

52. For many years up to and including the date of the filing of this complaint, Wellington has entered into and maintained contracts and combinations with each of the Wellington Funds, including defendant Wellington Fund, Inc., in unreasonable restraint of the aforesaid trade and commerce in the purchase and sale of mutual fund shares in violation of Section 1 of the Sherman Act.

53. The aforesaid unlawful contracts and combinations have consisted of continuing understandings and agreements, the substantial terms of which have been and are, that:

(a) Wellington must forward all orders from investors or broker/dealers to the appropriate Wellington Fund for sale only at the public offering price; and

(b) Wellington would arrange for the purchase of shares only from the appropriate Wellington Funds.

54. The effects of the aforesaid unlawful contracts and combinations have been and are, that:

(a) the public has been deprived the benefits of a secondary dealer market and a brokerage market in the purchase and sale of shares of the Wellington Funds; and

(b) broker/dealers have been deprived of the benefits of free and open competition in a secondary dealer market in shares of the Wellington Funds.

Count VIII

I

Defendants

55. Each broker/dealer defendant, as described in paragraph 7 hereof, is made a defendant herein.

II

Trade and Commerce

56. Paragraphs 9 through 14 hereof are realleged in full.

III

Violation Alleged

57. For many years, up to and including the date of filing of this complaint, each defendant broker/dealer has entered into and maintained contracts and combinations with numerous principal underwriters in addition to defendant principal underwriters, in unreasonable restraint of the aforesaid trade and commerce in the purchase and sale of mutual fund shares in violation of Section 1 of the Sherman Act.

58. The aforesaid unlawful contracts and combinations have consisted of continuing understandings and agreements, the substantial terms of which have been and are, that with respect to sales and purchases of shares of the funds distributed by the principal underwriter concerned, one or more of the following restrictions would be in effect:

(a) the broker/dealer must act as principal (dealer) only in the sale of such shares;

(b) if the broker/dealer acted as agent (broker) in the sale of such shares, it must maintain the public offering price;

(c) the broker/dealer must purchase such shares only from the principal underwriter, investors or the fund; and

(d) the broker/dealer must sell such shares only to the principal underwriter, investors, or the fund.

59. The effects of such unlawful contracts and combinations have been and are, among others, that:

(a) the public has been deprived of the benefits of competition in a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares; and

(b) the public has paid artificial and noncompetitive sales load charges for the purchase and sale of mutual fund shares.

Prayer

WHEREFORE, plaintiff prays:

1. That the contracts, combinations and conspiracies alleged in Counts I through VIII hereof be adjudged and decreed to be unlawful and in violation of Section 1 of the Sherman Act.

2. That the defendants and each of their officers, directors, agents, managers, employees, successors, assigns, members, and all other persons acting or claiming to act on behalf of the defendants be perpetually enjoined and restrained from directly or indirectly continuing, maintaining, enforcing, or renewing the aforesaid contracts, combinations, and conspiracies and from engaging in any practices, contracts, combinations, or conspiracies having like or similar purposes or effects.

3. That the defendant mutual funds, principal underwriters and broker/dealers and their officers, directors, agents, representatives, and all persons acting or claiming to act on their behalf be perpetually enjoined from entering into or maintaining any agreement containing:

(a) any limitation or restriction as to (i) the persons from whom any registered broker/dealer may purchase, or to whom any registered broker/dealer may sell, mutual fund shares (ii) a registered broker/dealer's right to act as broker in the purchase or sale of mutual fund shares; or

(b) any requirement as to the number of mutual fund shares that must be purchased from, or redeemed, liquidated or repurchased through, the mutual fund or its principal underwriter.

4. That each defendant mutual fund be required prominently to display in its prospectus a statement that shares of the fund may legally be purchased at less than the public offering price and sold at more than the redemption price if a broker/dealer acts as broker for another investor rather than dealer in the transaction.

5. That each defendant broker/dealer be required to inform prospective customers that mutual fund shares may legally be purchased for less than the public offering price if the broker/dealer agrees to act as agent rather than principal.

6. That defendant NASD and each of its officers, govern-

ors, agents, managers, employees, successors, assigns, and all other persons acting or claiming to act on behalf of the defendant NASD be perpetually enjoined from establishing, maintaining, or adhering to any rule or regulation, formal or informal, or suggesting any course of action for its members, which:

(a) requires or induces any member (i) to enter into any agreement or course of action enjoined by other paragraphs of this Prayer for Relief, (ii) to act as principal in the purchase or sale of mutual fund shares, or (iii) to refrain from purchasing mutual fund shares from, or from selling such shares to, any other broker/dealer;

(b) fixes the price for a brokerage transaction in mutual fund shares; or

(c) otherwise unreasonably impedes a secondary dealer market or a brokerage market in mutual fund shares.

7. That defendant NASD be required to display in all manuals, training guides and other literature distributed to members relating to the sale of investment company shares, a statement that any member broker/dealer, including any member principal underwriter which is also registered as a broker/dealer, is legally free to arrange for the purchase and sale of mutual fund shares at less than the public offering price by acting as broker between two customers.

8. That pursuant to Section 5 of the Sherman Act an order he made and entered herein requiring defendants Fidelity Fund, Inc., Massachusetts Investors Growth Stock Fund, Inc., and Wellington Fund, Inc., to be brought before this Court in this proceeding and directing the United States Marshals of the appropriate Districts to serve a summons on each of such defendants.

9. That the plaintiff have such other and further relief as the nature of the case may require and the Court may deem just and proper.

10. That plaintiff recover its taxable costs.

/s/ Richard G. Kleindienst
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ANSWER OF DEFENDANT NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Now comes Defendant NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., hereinafter referred to as "the Association," a corporation, through counsel, and states as and for its Answer to the Complaint:

First Defense

In specific answer to the allegations of the Complaint filed herein, Defendant Association states as follows:

1. Defendant Association denies each and every allegation contained in paragraph 1.

2. Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained in paragraph 2 except that it states that it may be found within the District of Columbia.

3. Defendant Association states that paragraph 3, including subparagraphs (a) through 3(h), constitute a statement of definitions selected or constructed by Plaintiff and are not capable of being either admitted or denied.

4. Defendant Association is without knowledge sufficient to either admit or deny the allegations contained in paragraphs 4 through 7.

5. Defendant Association admits the allegations contained in paragraph 8.

6. Defendant Association states that paragraphs 9 through 14 constitute statements incapable of being either admitted or denied or constitute allegations concerning which defendant Association does not have knowledge sufficient to either admit or deny.

7. Defendant Association denies each and every allegation contained in paragraph 15 through paragraph 18, including subparagraphs 17(a) through 17(e) and 18(a) and 18(b).

8. In answer to paragraph 19, Defendant Association reasserts the answer set forth hereinabove to paragraph 4.

9. In answer to paragraph 20, Defendant Association reasserts the answer set forth hereinabove to paragraph 7.

10. In answer to paragraph 21, Defendant Association

reasserts the answers set forth hereinabove to paragraphs 9 through 14.

11. In answer to paragraphs 22 through 24, including subparagraphs 23(a) and (b) and 24(a) through (d), Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

12. In answer to paragraphs 25 and 26, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

13. In answer to paragraph 27, Defendant Association reasserts the answers set forth hereinabove to paragraphs 9 through 14.

14. In answer to paragraphs 28 through 30, including subparagraphs 30(a) through (d), Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

15. In answer to paragraphs 31 and 32, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

16. In answer to paragraph 33 Defendant Association reasserts the answers set forth hereinabove to paragraphs 9 through 14.

17. In answer to paragraphs 34 through 36 including subparagraphs 35(a) and (b) and 36(a) and (b), Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

18. In answer to paragraphs 37 and 38, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

19. In answer to paragraph 39, Defendant Association reasserts the answers set forth hereinabove to paragraphs 9 through 14.

20. In answer to paragraphs 40 through 42, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

21. In answer to paragraphs 43 and 44, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

22. In answer to paragraph 45, Defendant Association reasserts the answers set forth hereinabove to paragraphs 9 through 14.

23. In answer to paragraphs 46 through 48, including

subparagraphs 47(a) through (c) and 48(a) and (b), Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

24. In answer to paragraphs 49 and 50, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

25. In answer to paragraph 51, Defendant Association reasserts the answers set forth hereinabove to paragraphs 9 through 14.

26. In answer to paragraphs 52 through 54, including subparagraphs 53(a) and (b) and 54(a) and (b), Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations set forth therein.

27. In answer to paragraph 55, Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations contained therein.

28. In answer to paragraph 56, Defendant Association reasserts the answers set forth hereinabove to paragraphs 9 through 14.

29. In answer to paragraphs 57 through 59, including subparagraphs 58(a) through (d) and 59(a) and (b), Defendant Association states that it is without knowledge sufficient to either admit or deny the allegations set forth therein.

Second Defense

The Complaint fails to state a cause of action as to Defendant Association upon which relief can be granted.

Third Defense

The Court does not have jurisdiction of the subject matter.

Fourth Defense

Defendant Association is exempted from application of the antitrust laws by the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.*, generally, and by Section 15A(n) of that act, 15 U.S.C. § 78o-3(n), specifically.

Fifth Defense

The conduct alleged in the Complaint as to Defendant Association is exempted from application of the anti-trust laws by the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.* and the Investment Company Act of 1940, as amended, 15 U.S.C. §§ 80a-1 through 80a-52.

Sixth Defense

Any action taken by Defendant Association in connection with any facts alleged in the Complaint was taken with the acquiescence, and under the active oversight, of the Securities and Exchange Commission pursuant to its responsibility as established by the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.*

Seventh Defense

Primary and exclusive jurisdiction to adjudicate the allegations made against Defendant Association in the Complaint rests with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.*, and the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 through 80a-52.

WHEREFORE, Defendant Association prays this Court:

1. To dismiss the Complaint filed herein and award costs to the Defendant Association, and
2. To grant such other relief as this Court may deem appropriate.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
Defendant

....

Lloyd J. Derrickson
Senior Vice-President and General Counsel

....

Dennis C. Hensley
Assistant General Counsel

Dated: March 26, 1973

(Certificate of Service omitted in printing)

Answer of Defendant

Massachusetts Investors Growth Stock Fund, Inc.

(Title Omitted in Printing)

ANSWER

Defendant Massachusetts Investors Growth Stock Fund, Inc. ("MIGS"), by its attorneys, for its answer to Count V of the complaint herein:

1. Denies the allegations of paragraph 1 of the complaint except admits that plaintiff purports to bring this action under 15 U.S.C. § 4.

2. Denies knowledge or information sufficient to form a belief as to the allegations of paragraph 2 of the complaint except admits that it may not be found and does not transact business within the District of Columbia.

3. States that paragraph 3 of the complaint does not require an answer.

4. Denies the allegations of paragraph 37 of the complaint except admits and avers as follows: MIGS is a Massachusetts corporation and is an open-end, diversified investment company of the type commonly known as a "mutual fund." MIGS had net assets of approximately $1,634,718,730 on December 31, 1972. In fiscal 1972 MIGS issued shares having a net asset value of approximately $97,741,482 and redeemed or repurchased shares having a net asset value of approximately $102,060,568.

5. Denies knowledge or information sufficient to form a belief as to the allegations of paragraph 38 of the complaint except admits and avers that Vance, Sanders & Company, Inc., a Maryland corporation having its principal place of business in Boston, Massachusetts, is the principal underwriter of MIGS and that MIGS has given notice of the termination, effective June 30, 1973, of the underwriting agreement between it and Vance, Sanders & Company, Inc.

6. As an answer to paragraph 39 of the complaint:

(a) Denies knowledge or information sufficient to form a belief as to the allegations of paragraph 9 of the complaint except admits and avers as follows: MIGS is an open-end diversified investment company as those terms are defined in sections 3 and 5 of the Investment Company Act of 1940, as amended. Said type of investment company is commonly known as a "mutual fund." MIGS continuously issues and stands ready to redeem its shares. MIGS currently distributes its shares through a principal under-

writer which has the exclusive contractual right, except in certain limited circumstances, to buy shares from MIGS. Shareholders of MIGS have the right to redeem their shares through MIGS' transfer agent and MIGS has also authorized its principal underwriter to act as its agent in repurchasing shares.

(b) Denies knowledge or information sufficient to form a belief as to the allegations of paragraph 10 of the complaint.

(c) Denies knowledge or information sufficient to form a belief as to the allegations of paragraph 11 of the complaint except admits and avers as follows: Shares of MIGS are sold to the public at a current offering price described in MIGS' prospectus. The public offering price is the net asset value prevailing at the time of purchase, plus a sales charge. The sales charge on MIGS' shares is 8½% of the offering price for purchases of less than $12,500, 7½% of the offering price for purchases of $12,500 but less than $25,000, 5¾% of the offering price for purchases of $25,000 but less than $50,000, 4% of the offering price for purchases of $50,000 but less than $100,000, 3¼% for purchases of $100,000 but less than $250,000, 2½% for purchases of $250,000 but less than $500,000, 2¼% for purchases of $500,000 but less than $1,000,000 and 1¾% for purchases of $1,000,000 or more. MIGS redeems its shares at net asset value.

(d) Denies knowledge or information sufficient to form a belief as to the allegations of paragraph 12 of the complaint except admits and avers as follows: MIGS' principal underwriter, acting as principal, currently allows its dealers discounts from the applicable public offering price. On sales for which the maximum sales charge is applicable, the dealer retains 6½% and the principal underwriter retains 2% of the public offering price, except in the case of subsequent investments under the Lifetime Investing Account's Services for Accumulation.

(e) Denies the allegations of paragraph 13 of the complaint and refers to Section 22(d) of the Investment Company Act of 1940, as amended, for the terms thereof.

(f) Denies the allegation of paragraph 14 of the complaint.

7. Denies the allegations of paragraphs 40, 41 and 42 of the complaint.

First Affirmative Defense

8. As a first affirmative defense, alleges and avers that venue in this district is improper.

Second Affirmative Defense

9. As a second affirmative defense, alleges and avers that the transactions complained of are prescribed by, governed by and exempted from the antitrust laws by Section 22 of the Investment Company Act of 1940, as amended.

Third Affirmative Defense

10. ~~As a third~~ affirmative defense, alleges and avers that the transactions complained of are prescribed by, governed by and exempted from the antitrust laws by the Rules of Fair Practice and By-Laws of the National Association of Securities Dealers and Section 15A of the Securities Exchange Act of 1934.

Fourth Affirmative Defense

11. As a fourth affirmative defense, alleges and avers that primary jurisdiction over this matter rests in the Securities and Exchange Commission.

Fifth Affirmative Defense

12. As a fifth affirmative defense, alleges and avers that this action is barred by the doctrine of laches.

Sixth Affirmative Defense

13. As a sixth affirmative defense, alleges and avers that the complaint fails to state a claim upon which relief can be granted.

WHEREFORE, this defendant demands judgment dismissing the complaint and providing such other and different relief as to this Court may seem just and proper.

SULLIVAN & CROMWELL
By ....
(A Member of the Firm
48 Wall Street,
New York, New York 10005
(212) HAnover 2-8100

and

DAVIS R. ROBINSON

Davis R. Robinson
815 Connecticut Avenue, N.W.,
Washington, D.C. 20016
(212) 298-8020
Attorneys for Defendant
Massachusetts Investors Growth
Stock Fund, Inc.

DATED: March 26, 1973

(Certificate of service omitted in printing)

(Title Omitted in Printing)

ANSWER OF DEFENDANTS THE CROSBY CORPORATION AND FIDELITY FUND, INC.

Defendants The Crosby Corporation ("Crosby") and Fidelity Fund, Inc. ("Fidelity"), by their attorneys, answer the complaint as follows:

1. Admit that the complaint seeks relief for alleged violations of Section 1 of the Sherman Act as stated in paragraph 1 of the complaint.

2. Deny knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 2 of the complaint, except admit that Fidelity does not transact business and is not found within the District of Columbia, and deny that Crosby transacts business or is found within the District of Columbia.

3. Admit the definitions contained in paragraph 3 of the complaint are those used within the complaint.

Answering Count I

4. Admit the allegations contained in paragraph 4 of the complaint, except deny that Crosby is at present acting as principal underwriter for Essex Fund, Inc.

5. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 5, 6 and 7 of the complaint.

6. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 8 of the complaint, except admit that Crosby is a member of defendant National Association of Securities Dealers.

7. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 9 of the complaint, except admit the allegations contained in the first two sentences of paragraph 9 and that mutual funds are required by law to redeem their shares on demand.

8. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 10 of the complaint.

9. Deny knowledge or information sufficient to form a

belief as to the truth of the allegations contained in paragraph 11 of the complaint, except admit that shares of "load" mutual funds are sold at a public offering price described in the fund's prospectus which is based on the net asset value of the fund plus a sales load.

10. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 12 of the complaint.

11. Deny the allegations contained in paragraphs 13 and 14 of the complaint, and respectfully refer the Court to Section 22(d) of the Investment Company Act of 1940 for the provisions thereof.

12. Deny the allegations contained in paragraphs 15 through 18 of the complaint.

Answering Count II

13. The allegations contained in paragraphs 19 and 20 of the complaint do not require further answer.

14. With respect to paragraph 21 of the complaint, defendants repeat and reallege the admissions and denials set forth in this answer with respect to paragraphs 9 through 14 of the complaint as if here fully set forth.

15. Deny the allegations contained in paragraphs 22 and 23 of the complaint, and respectfully refer the Court to the standard dealer agreement between Crosby and broker/dealers distributing Fidelity shares, a copy of which is annexed hereto as Exhibit A, for the terms and conditions thereof.

16. Deny the allegations contained in paragraph 24 of the complaint.

Answering Count III

17. To the extent that paragraphs 25 and 26 require further answer, admit the allegations contained therein, except deny that Fidelity has assets of $1.86 billion.

18. With respect to paragraph 27 of the complaint, defendants repeat and reallege the admissions and denials set forth in this answer with respect to paragraphs 9 through 14 of the complaint as if here fully set forth.

19. Deny the allegations contained in paragraphs 28 through 30 of the complaint.

20. Counts IV through VIII assert no claim against de-

fendants Crosby and Fidelity, and therefore no answer is required as to paragraphs 31 through 59.

First Defense

21. The complaint fails to state a claim upon which relief can be granted.

Second Defense

22. The Court does not have jurisdiction over the persons of defendants Crosby and Fidelity.

Third Defense

23. Each and every sales agreement between defendant Crosby and the defendant broker/dealers, a typical sample copy of which is annexed as Exhibit A, contains the following provisions, among others:

> "You agree not to purchase as principal or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the then currently effective applicable Fund prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us or the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction."

24. A true sample copy of the then existing sales agreements between defendant Crosby and defendant broker/dealers was and is an exhibit to and made a part of registration statements filed with the Securities and Exchange Commission ("Commission") in conection with the issuance, sale and distribution of shares in the load mutual funds included in the Fidelity Group of Funds, and particularly the shares of Fidelity, and in the event of any change in said agreements, a true copy of the new sales

agreement is filed with the Commission in accordance with its rules and regulations.

25. The sales agreements and practices of these defendants which are alleged in the complaint to be in violation of the Sherman Act were and are authorized by the Investment Company Act and by the Commission, and therefore are exempt from the operation of the Sherman Act.

Fourth Defense

26. The Investment Company Act vested the Commission with the exclusive power and authority to regulate and supervise continuously the investment company industry and the activities of those engaged therein, and to protect the public interest and especially the interests of investors in mutual funds against any and all evils and abuses arising from the agreements, practices or other activities of investment companies, investment advisors, dealers and broker/dealers, including methods employed in the issuance, distribution, sale, purchase, redemption and resale of the shares of open-end investment companies.

27. By reason of the foregoing, the agreements, transactions and practices alleged in the complaint to be in violation of the Sherman Act are exempt from the provisions of the Act.

Fifth Defense

28. By reason of the authority vested in the Commission under the Securities Exchange Act of 1934 and Investment Company Act of 1940, primary jurisdiction to regulate the agreements and activities complained of and to deal with any legal challenge to the practices and procedures connected with the distribution and sale of mutual fund shares rests with the Commission.

Prayer

WHEREFORE, defendants pray for judgment dismissing the complaint on the merits and awarding defendants the costs and disbursements of this action and reasonable counsel fees and such other and further relief as this Court deems just and proper.

Dated: March 26, 1973

/s/ Daniel P. Levitt
DANIEL P. LEVITT
Attorney for Defendants The Crosby Corporation and Fidelity Fund, Inc.

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SALES AGREEMENT

The Crosby Corporation,
Distributor
225 Franklin Street,
Boston, Mass. 02110
Executive Offices—
617-726-0400—Cable-
Crosfidel
Order Department—
617-742-5700—Teletype
710-321-0411

Fidelity Fund, Inc.
Fidelity Debenture Fund, Inc.
Fidelity Capital Fund, Inc.
Fideltiy Trend Fund, Inc.
Puritan Fund, Inc.
Salem Fund, Inc.
Everest Fund, Inc.

The Fidelity Group of Mutual Funds

November 1, 1972

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price computed as described in the applicable Fund's then currently effective Prospectus, less the Dealer Discount described below. The net asset value and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Sales Charge Paid by Investor	Dealer Discount
On investments of	*	$ 10,000	8.5%	7.0%
On investments of	$ 10,000	20,000	8.0%	6.5%
On investments of	25,000	50,000	6.0%	4.8%
On investments of	50,000	100,000	4.5%	3.6%
On investments of	100,000	250,000	3.5%	2.8%
On investments of	250,000	500,000	2.5%	2.0%
On investments of	500,000	1,000,000	2.0%	1.6%
On investments over	1,000,000		1.0%	0.8%

* The minimum initial and subsequent investments must be as specified in the then currently effective applicable Fund Prospectus.

The schedule of sales charges and dealer discounts set forth above is applicable to purchases by "any person" (a) of a single Fund at any one time, or (b) in accordance with "Combined Purchase Privilege," "Cumulative Quantity Discount" and/or "Statement of Intention" as each of those terms is described in the then currently effective applicable Fund Prospectus. You must notify us of the total holdings, if applicable, of "any person" before he may avail himself of a reduced sales charge pursuant to the foregoing. Such notification, in writing, must be received by Crosby within four (4) business days of the placing of the order. An application form is available for this purpose. As used in this paragraph, "any person" means an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other like fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the applicable Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made as follows:

The Crosby Corporation
Cash Clearing Department, 3rd Floor
Ten Post Office Square
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100. WE RESERVE THE RIGHT TO HOLD YOU RESPONSIBLE FOR ANY LOSS WE MAY INCUR AS THE RESULT OF YOUR FAILURE TO MAKE ANY SUCH PAYMENTS.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the net asset value then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the then currently effective applicable Fund Prospectus), unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling to us for the account of an investor any shares of the appropriate Fund at the net asset value price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not pur-

chase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the dealer discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, as amended, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the then currently effective applicable Fund Prospectus and in such other printed information as may be subsequently issued by us as information supplemental to such Prospectus or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," Fidelity Trend Fund, Inc.," "Salem Fund, Inc.," "Everest Fund, Inc.," "Fidelity Bond-Debenture Fund, Inc.," "Fidelity Group of Funds" or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent or representative of any of the Funds or of this Corporation, and you are not

authorized to act for use or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

This Agreement supersedes and cancels any prior agreement with respect to the sale of shares of any of the Funds for which we are the principal underwriter and we reserve the right to amend this Agreement at any time and from time to time or to terminate the same at any time.

We and/or the Funds in the Fidelity Group of Funds may at any time modify the sales charge and dealer discount to be paid in connection with the sale of shares of any of those Funds. In the event of any such change you agree that you will have no continuing claim to or vested interest in the level of sales charges or dealer discounts established by this Agreement as to any shares purchased subsequent to such change.

Very truly yours,
THE CROSBY CORPORATION
By ....

The undersigned hereby accepts this Agreement and agrees to abide by all of its terms and conditions.

Dated ...., 19.. Firm ....
By ....
Authorized Signature
Address ....

(Title Omitted in Printing)

ANSWER OF DEFENDANT WELLINGTON FUND, INC.

Comes now Wellington Fund, Inc. named as one of the defendants in the above styled case, and answers and responds to the complaint as follows:

First Defense

The complaint fails to state a claim against the defendant upon which relief can be granted.

Second Defense

The alleged unlawful activities of this defendant were required by the Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq.*, the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.*, and rules and regulations adopted pursuant to such Acts, and are exempt from the prohibitions of the antitrust laws.

Third Defense

The Court lacks jurisdiction over the subject matter of the complaint and the person of the defendant.

Fourth Defense

1.

With respect to the section of the complaint entitled "Jurisdiction and Venue" this defendant admits that the complaint purports to seek relief under § 4 of the Sherman Act (15 U.S.C. § 4), admits that it is not found and does not transact business in the District of Columbia, and is without knowledge or information sufficient to form a belief as to whether the other defendants are found or transact business in the District of Columbia.

2.

With respect to the section of the complaint entitled "Definitions," this defendant admits the definitions con-

tained in paragraphs 3(a)-(e) and denies the statement of the definitions contained in paragraphs 3(f)-(h).

3.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 4 and 5 of the complaint.

4.

This defendant admits the allegations contained in paragraph 6 of the complaint.

5.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 7 and 8 of the complaint.

6.

This defendant admits that Wellington Management Company, Inc. acts as principal underwriter for it and for the six other open-end management investment companies listed in paragraph 6 of the complaint (which investment companies are registered with the Securities and Exchange Commission under the Investment Company Act of 1940), pursuant to an underwriting agreement, a specimen copy of which is attached hereto as Exhibit A, and which is filed with the Securities and Exchange Commission as required by the Investment Company Act of 1940 and regulations issued thereunder. This defendant also admits that Wellington Management Company, Inc. has existing sales agreements with each of the defendants named in paragraph 7 of the complaint relating to the sale of shares of each of the registered open-end management investment companies for which Wellington Management Company, Inc. acts as principal underwriter, a specimen copy of which is attached hereto as Exhibit B, and specimens of which are on file with the Securities and Exchange Commission as required by the Investment Company Act of 1940 and regulations issued thereunder. The underwriting agreement referred to above is the only agreement relating to the sale of such shares between this defendant and Wellington

Management Company, Inc. The sales agreement referred to above is the only agreement referring to the sales of the shares of this defendant between Wellington Management Company, Inc. and the broker-dealers named in paragraph 7 of the complaint. This defendant also admits that it must redeem its shares in accordance with the provisions of the Investment Company Act of 1940. Other than as stated above, this defendant denies, or is without information sufficient to form a belief as to the truth of the allegations contained in paragraph 9.

7.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 10 of the complaint.

8.

With respect to the allegations of paragraphs 11 and 12 of the complaint, this defendant admits that its shares are normally sold at an offering price described in the prospectus as required by § 22(d) of the Investment Act of 1940, and set forth in the sales agreement attached hereto as Exhibit B. Except as stated above this defendant either denies or is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 11 and 12 of the complaint.

9.

With respect to paragraphs 13 and 14 of the complaint, this defendant avers that the allegations contained therein constitute conclusions of law incapable of being either admitted or denied. To the extent such allegations may be deemed to be allegations of material fact they are denied.

10.

This defendant denies the allegations contained in paragraphs 15, 16, 17 and 18 of the complaint.

11.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations

contained in paragraphs 19, 20, 22, 23 and 24. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 21 of the complaint.

12.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 25, 26, 28, 29 and 30. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 27 of the complaint.

13.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 31, 32, 24, 35 and 36. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 33 of the complaint.

14.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 37, 38, 40, 41 and 42. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 39 of the complaint.

15.

With respect to the allegations contained in paragraphs 43 through 48 of the complaint this defendant reasserts its response contained in paragraphs 6 through 9 of this Fourth Defense. Except as stated above, this defendant denies the allegations contained in paragraphs 43 through 48.

16.

This defendant admits the allegations of paragraph 49.

17.

With respect to the allegations contained in paragraphs 50 through 54 of the complaint, this defendant reasserts its

response contained in paragraphs 6 through 9 of this Fourth Defense. Except as stated above this defendant denies the allegations contained in paragraphs 50 through 54 of the complaint.

18.

With respect to the allegations contained in paragraphs 55, 57 through 59 of the complaint, defendant admits that Wellington Management Company, Inc. has in effect sales agreements with the broker-dealers named in paragraph 7 of the complaint (a specimen copy of which is attached as Exhibit B) with respect to the sale of this defendant's shares. This defendant reasserts its response contained in paragraphs 6 ~~through 9~~ of this Fourth Defense in response to the allegations of paragraph 56 of the complaint. Except as stated above, this defendant denies the allegations contained in paragraphs 55 through 59.

WHEREFORE, this defendant files its answer to the plaintiff's complaint and prays that the complaint be dismissed.

By Robert E. Jensen
ROBERT E. JENSEN

OF COUNSEL:

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By W. L. Dickey
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Washington, D.C. 20036
Tel. (202) 223-6150

(Certificate of Service Omitted in Printing)

EXHIBIT A

UNDERWRITING AGREEMENT

THIS AGREEMENT, by and between WELLINGTON FUND, INC. a corporation organized and existing under the laws of the State of Maryland (hereinafter called "FUND") and WELLINGTON MANAGEMENT COMPANY, a corporation organized and existing under the laws of the State of Delaware (hereinafter called "COMPANY"):

WITNESSETH:

WHEREAS, FUND is an open-end investment company registered under the Investment Company Act of 1940, the shares of which are registered under the Securities Act of 1933, and is desirous of issuing to the general public all of its now or hereafter authorized, but unissued, shares of capital stock and/or shares of capital stock now or later held in its Treasury; and

WHEREAS, COMPANY is interested in promoting the growth of FUND and will be equipped financially and with qualified personnel and extensive facilities to encourage the sale of shares of FUND by investment dealers and to create and provide the sales literature, advertising and other sales promotional aids necessary to accomplish such growth.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto hereby covenant and agree to and with each other as follows:

1. (a) COMPANY agrees to act as the principal underwriter and exclusive national distributor for the shares of FUND and will, upon receipt of unconditional orders from investment dealers or investors (and not before), transmit such bids or orders as agent for FUND for acceptance and confirmation by FUND to its principal office as FUND may from time to time direct. The price at which shares of FUND are offered to the public through COMPANY shall be computed and shall be effective as set forth in the Prospectus of FUND current as of the time of such sale.

(b) FUND reserves the right to reject any order, provided, however, that FUND does hereby covenant and agree that it will not arbitrarily or without reasonable cause refuse acceptance or confirmation of orders obtained and

submitted under this Agreement for the purchase of shares of stock of FUND and, upon receipt thereof, will in all proper cases confirm orders directly through the COMPANY as agent for FUND or authorize the COMPANY, as agent for FUND, to deliver proper confirmations and, if requested, will deliver certificates for shares so purchased to COMPANY as soon as practicable after receipt of payment therefore in cash.

(c) COMPANY agrees that it will not directly or indirectly withhold orders for the purchase of stock of FUND or purchase stock of FUND in anticipation of orders, and does further agree that in all contracts or arrangements with dealers or distributors acting under or through it, it will require a similar contractual undertaking. COMPANY further agrees that it will arrange for the purchase of shares of FUND only from FUND, except when acting as agent for FUND on repurchase of shares under Paragraph 2 hereof.

2. Sales of FUND's shares under this Agreement shall be handled by COMPANY as agent for FUND. With FUND's consent, COMPANY may also act as agent for FUND without commission on repurchase of shares of FUND. Except for such sales and repurchase of shares of FUND, COMPANY shall act as principal in all other matters relating to promotion of the growth of FUND and shall enter into all of its engagements, agreements and contracts as principal on its own account. Furthermore, this Agreement shall not be construed as authorizing any dealer or other person to act as agent, either of FUND or of COMPANY.

3. FUND covenants and agrees that it will, at its own expense:

(a) use its best efforts to keep authorized, but unissued, sufficient of its capital stock to meet the reasonable requirements of COMPANY;

(b) execute or cause to be executed all documents requiring signatures of FUND necessary to permit COMPANY to comply with the provisions of Paragraph 4 hereof;

(c) supply COMPANY with the "net asset value per share" computed as at the time(s) prescribed by and in compliance with all pertinent requirements of the National Association of Securities Dealers and the Securities and Exchange Commission, so as to permit COMPANY to comply with the provisions of Paragraph 4 hereof.

4. COMPANY covenants and agrees that it will, at its own expense:

(a) prepare, file and keep effective registration statements, prospectuses and licenses covering so many shares of stock of FUND as may be necessary to meet COMPANY's reasonable requirements for distribution and sale of such shares in all jurisdictions where shares of FUND may lawfully be sold;

(b) prepare as often as, and at the specific times, required by appropriate authority on each business day for publication in newspapers or other financial publications both the offering price to the public and the liquidation price of FUND shares;

(c) prepare, print and distribute (subject to the provisions of Paragraph 5 hereof) all advertising and sales literature relating to FUND.

5. (a) COMPANY does hereby covenant and agree that it will not issue any statements other than FUND's properly approved Prospectus, except such supplemental literature or advertising (prepared at the expense of COMPANY) as shall be lawful under state and federal securities laws and regulations and under applicable laws and regulations of foreign jurisdictions. COMPANY agrees to file with the Securities and Exchange Commission, the National Association of Securities Dealers, Inc. and such other regulatory authorities as may be required, copies of any advertisement, pamphlet, circular, form letter, or other sales literature relating to FUND or its shares, addressed to or intended for distribution to prospective investors, within the time required by such regulatory authorities, to furnish FUND at its principal office with a copy of all such material prior to its use and not to use such material if the FUND shall reasonably and promptly object to such use.

(b) COMPANY shall conform to all applicable By-Laws, charter provisions, and regulations to which FUND is subject and to applicable laws and regulations of the United States and of the individual states within which COMPANY or FUND may do business, or where shares of FUND are offered for sale, and will conduct its affairs both with relation to FUND and with relation to dealers, or investors, in accordance with the rules of fair practice of the National Association of Securities Dealers, Inc. COMPANY shall also comply with applicable laws and regulations of foreign

jurisdictions in which shares of FUND or securities of an investment company using shares of FUND as its sole underlying investment are offered.

(c) COMPANY agrees to indemnify and hold harmless FUND and each person who has been, is, or may hereafter be an officer or director of FUND against expenses reasonably incurred by any of them in connection with any claim or in connection with any action, suit or proceeding to which any of them may be a party, which arises out of, or is alleged to arise out of any wrongful act of COMPANY or its employees or any misrepresentation in the registration statement of FUND filed under the Securities Act of 1933 of a material fact, or out of any alleged omission to state therein a material fact necessary to make the statements made therein not misleading, insofar as any such statement or omission was made in reliance upon, and in conformity with, information furnished to FUND in connection therewith by, or in behalf of COMPANY, provided, however, that (i) in no case is the indemnity of COMPANY in favor of FUND or any person indemnified to be deemed to protect FUND or any such person against any liability to which FUND or any such person would otherwise be subject by reason of willful misfeasance, bad faith or gross negligence, in the performance of its duties or by reason of its reckless disregard of its obligation and duties under this agreement, and (ii) in no case is COMPANY to be liable under its indemnity agreement contained in this paragraph with respect to any claim made against FUND or any person indemnified, unless FUND or such person, as the case may be, shall have notified COMPANY in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon FUND or upon such person (or after FUND or such person shall have received notice of such service on any designated agent). In the case of any such notice to COMPANY, COMPANY shall be entitled to participation, at its own expense, in the defense of any suit brought to enforce any such liability. COMPANY agrees promptly to notify FUND of the commencement of any litigation or proceedings against it in connection with the issue and sale of any of the shares. The term "expenses" includes amounts paid in satisfaction of judgments or in settlement. The foregoing right of indemnification shall be in addition to any other rights to

which Fund or any such officer or director may be entitled as a matter of law.

6. Fund covenants and agrees that it will not, during the term of this Agreement offer any of its shares for sale directly or through any person or corporation other than Company, excepting only (a) the issuance of rights to stockholders to subscribe to shares to the extent of all or part of any dividend that may be distributed to stockholders of Fund or to the extent of any shares that may be taken up under an optional or alternative dividend, or the issuance of additional shares through stock splits or stock dividends, and (b) sales of shares to another investment or securities holding company in the process of converting all or a portion of its assets into shares of Fund or in connection with an issuance of Fund's shares in exchange for shares of another investment or securities holding company, to the extent permitted by the Investment Company Act of 1940, as from time to time amended. Provided, however, that in the event Company should be unable to continue to distribute shares of Fund and such restriction shall not apply to the sale of shares of Fund by any other person, Fund may at its option make arrangements for the offer and sale of its shares within the jurisdiction or jurisdictions in which distribution and sale thereof by Company has been prevented, provided, further however, that if Company shall have removed all material obstacles to resuming the offer and sale within said jurisdictions within ninety days from its first restraint or inability, then the right of Fund to distribute through instrumentalities other than Company shall be extinguished, subject only to the provisions of Paragraph 8 hereof. Fund further agrees that Company may act as principal underwriter and exclusive national distributor for the shares of other investment companies registered under Investment Company Act of 1940. Fund and Company further agree that the shares of the Fund may be sold through Company as agent for the Fund to any investment company which uses the shares of the Fund as its sole underlying investment, provided that such other investment company is sponsored by the Company (or, if a United States investment company, sponsored by a distributor approved by the Company), or by a wholly-owned subsidiary of the Company and, provided further, that if such investment company is organized under

the laws of the United States or is designed to permit its securities to be sold to United States citizens or residents, it shall additionally register under the Investment Company Act of 1940, as from time to time amended.

7. It is hereby mutually agreed that COMPANY in full satisfaction of all services herein agreed to be performed by it shall receive a commission not to exceed 8½% of the offering price of all shares of FUND sold by it after the effective date hereof; provided, however, that the commission payable on separate volume and other special transactions shall be as from time to time set forth in the Prospectus of FUND then in effect, provided further that, if the Prospectus of the FUND so specifies, COMPANY shall receive no commission on sales of shares of FUND at net asset value to those persons described and on the terms provided in Rule 22d-1(h) promulgated under the Investment Company Act of 1940, as amended. The commissions aforesaid shall become due and owing immediately upon settlement for any sale made through COMPANY and COMPANY shall deduct such commissions from any remittance to FUND, provided, however, that if change is required in the aforesaid commissions, either by duly constituted regulatory authorities, or for business reasons, the amount payable to FUND from the sale of shares shall always equal the then current net asset value per share. COMPANY agrees that, if shares are repurchased by FUND or by COMPANY as agent for FUND, or are tendered to FUND for redemption within seven days after confirmation by COMPANY, as agent, of the original purchase order to any broker or dealer originating such transaction, COMPANY will immediately remit to FUND the commission (net of allowances of dealers or brokers) on such sale paid to COMPANY and will promptly, upon receipt thereof, pay to FUND any refunds of the balance of sales commissions repaid to COMPANY by brokers or dealers. Notwithstanding the foregoing, all sales of shares of FUND to any investment company in accordance with the provisions of Paragraph 6 of this Agreement as amended shall be made through COMPANY at net asset value, and no commissions shall be charged to, or paid by, such investment company with respect to such shares.

8. This Agreement shall become effective on April 1, 1973, and shall continue in force until March 31, 1975, and thereafter, only so long as such continuance is approved at

least annually thereafter by a vote of the Fund's Board of Directors, including the votes of a majority of the directors who are not parties to such Contract or interested persons of any such party, cast in person at a meeting called for the purpose of voting such approval.

9. Subject to the provisions of the immediately preceding paragraph, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors, provided, however, that this Agreement shall terminate automatically upon assignment by COMPANY as provided for and defined in the Investment Company Act of 1940 as amended, unless under the exemptive provisions of Section 6(c) of such Act, the Securities and Exchange Commission shall determine that a conditional or unconditional order of exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purpose fairly intended by the policy and practice of such Act; in which event this Agreement shall continue in full force and effect.

10. In the event that this Agreement, or any part thereof, shall become unlawful under any future law of the United States, or any state, territory, possession or district thereof, or any regulations of the United States, any state, territory, possession and district thereof, or any department, board or commission or other governmental authority having jurisdiction over its performance, such unlawful portion of the Agreement shall be considered as though it were deleted by mutual consent; but the remaining provisions of the Agreement shall not cease and terminate and the parties hereto shall confer and attempt to agree to such change or modification in the said Agreement as will cause it to conform to said law or regulation and will maintain the general purpose and provisions of this Agreement in a manner equitable to each of the parties hereto. If, in such event, the parties hereto are unable to agree with respect to the said modification, each shall promptly appoint one arbitrator and the two arbitrators so appointed shall appoint a third arbitrator, who shall consider all the facts and circumstances relating to this Agreement and to the necessary modification thereof to comply with such future law or regulation, and if, in the opinion of said arbitrators, or a majority of them, a modification of the said Agreement may be made which will comply with the said new law or regula-

tion and will maintain the general purposes of this Agreement and be fair and equitable to both of the parties hereto, they shall direct in what particulars this Agreement shall be modified and amended, and upon the receipt by each of the parties hereto of the written report of the arbitrators, the Agreement shall thereupon be deemed to be altered and amended as provided in the said report and as so altered and amended shall continue to be effective and binding on both of the parties hereto. The provisions of this Paragraph 10 shall be administered in accordance with provisions of the Act of Assembly of the Commonwealth of Pennsylvania, enacted April 25, 1927, P.L., 381 Number 248, as amended. Provided, however, that neither FUND, nor COMPANY, shall be bound to accept the directions of the arbitrators if the modification or amendment of the Agreement stated in the Arbitrators' written report would, in the opinion of counsel for FUND, require approval under the provisions of Section 15(c) of the Investment Company Act of 1940, as amended, and provided further that FUND reserves the right in the event of any award or decision by the arbitrators to call a special meeting of the stockholders of the FUND and to submit to the vote of the stockholders the question of whether the recommendations of the arbitrators shall or shall not be adopted by and binding upon the FUND, in which case the decision of the stockholders shall be final and binding upon FUND and COMPANY.

11. It is the intention of the parties hereto that this Agreement shall be governed and construed according to the laws of the Commonwealth of Pennsylvania.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective duly authorized officers and to have hereunto affixed their respective corporate seals this First day of April, 1973.

Attest:
Secretary
Attest:
Secretary

WELLINGTON FUND, INC.
By:
President

WELLINGTON MANAGEMENT COMPANY
By:
President

EXHIBIT B

WELLINGTON MANAGEMENT COMPANY
1630 LOCUST STREET • PHILADELPHIA, PA. 19103

Sales Agreement

with respect to

WELLINGTON FUND WINDSOR FUND IVEST FUND W. L. MORGAN GROWTH FUND WELLESLEY INCOME FUND EXPLORER FUND TRUSTEES' EQUITY FUND

Gentlemen:

As National Distributor for the shares of Wellington Fund, Windsor Fund, Ivest Fund, Explorer Fund, W. L. Morgan Growth Fund, Trustees' Equity Fund, Wellesley Income Fund, and any other mutual fund for which we may hereafter act as Distributor (the "Funds"), we invite you to become a member of the Selling Group to distribute the shares of said Funds upon the following terms:

Ordering of Shares

1. Orders received from you will be accepted by us for the Funds only at the public offering price applicable to each order, as established in accordance with the provisions of the then current Prospectus of each of the Funds. The procedure stated herein relating to the pricing and handling of orders shall be subject to instructions which we will forward from time to time to all members of the Selling Group. All orders are subject to acceptance or rejection by the Funds in their sole discretion.

2. You agree to purchase shares only from the Funds through us or from your customers. If you purchase shares from the Funds you agree that all such purchases shall be made only to cover orders already received by you from your customers (who may be any persons other than a securities dealer or broker), or for your own investment. If you purchase shares from your customers, you agree to pay such customers not less than the bid prices quoted by us as agent at the time of such purchase. As distributor, we will not accept a conditional offer for shares of the Funds.

3. You agree to sell shares only

(a) as principal, for your own account, to customers at the public offering price then in effect;

(b) to the Funds through Wellington Management Company, as agent for the Funds at the net asset value next determined after our receipt of the request for repurchase of the shares subject to such procedural standards as may from time to time be established or approved by the appropriate regulatory agencies. In such a sale to the Funds you may act either as principal for your own account or as agent for your customer. If you act as principal for your own account, you agree to pay your customer (unless the shares are in your investment account) not less than the price so determined. If you act as agent for your customer in selling shares to the Funds you may charge a fair commission for handling the transaction. All transactions in shares of Funds between you and us are between us as agent for the Funds concerned and you, either as principal for your own account or as agent for an undisclosed principal.

Dealer Discount and Sales Charge

4. The shares of the Funds will be offered to the public at a public offering price which will include a sales charge in varying amounts depending on the size of the purchase or other circumstances as described in the then current Prospectus of each of the Funds. On such sales you will receive a discount as shown in the following table (with the sales charge and discount stated as a percentage of the applicable offering price).

Amount of Sale	Gross Sales Charge	Dealer Discount
Less than $10,000 *	8.50%	7.00%
$10,000 but under $25,000	7.75	6.25
$25,000 but under $50,000	6.00	4.50
$50,000 but under $100,000	4.50	3.50
$100,000 but under $250,000	3.25	2.50
$250,000 but under $500,000	2.50	2.00
$500,000 but under $1,000,000	2.00	1.50
$1,000,000 but under $5,000,000	1.50	1.125
$5,000,000 and over	1.00	0.75

* The minimum initial purchase for Explorer Fund is $5,000.

5. The Funds may change the amount of the gross sales charge or the dealer discount or both at any time upon written notice to you.

6. You shall not withhold placing with us orders received from your customers so as to profit yourself as a result of such withholding, nor shall we accept from you any order for shares on any basis other than in accordance with the rules for such orders as may, from time to time, be established by the appropriate regulatory agencies.

7. If any shares sold to you under the terms of this agreement are repurchased by the Funds or by Wellington Management Company for the account of the Funds, or are tendered for repurchase or redemption within seven business days after the date of the confirmation of the original purchase by you, it is agreed that you shall forfeit your right to any discount received by you on such shares.

We shall notify you of any such repurchase or redemption within ten business days from the date on which the certificate is delivered to Wellington Management Company, or to the Funds and you shall forthwith refund to us the full discount allowed to you on such sale. We agree, in the event of any such repurchase or redemption, to refund to the Funds our share of the sales charge and upon receipt from you of the refund of the discount allowed to you, to pay such refund forthwith to the Funds.

8. Notwithstanding any of the foregoing provisions, orders to purchase shares received by us in connection with any exchange privilege made available to the shareholders of the respective Funds will be at the public offering price less all sales charges as applicable to each order and established by the then effective Prospectus of the Fund concerned. Orders to redeem shares under such exchange privilege shall not be subject to commission charge by either you or us.

Payment and Delivery

9. Orders and confirmation should be sent directly to Wellington Management Company, 1630 Locust Street, Philadelphia, Pa. 19103. Payment for shares shall be made payable to the order of Wellington Management Company and sent to the Funds' Transfer Agent, Data-Sys-Tance, Inc., P. O. Box 1400, Kansas City, Mo. 64141. The Funds reserve the right to delay issuance or transfer until the

check is cleared. Payment shall be received by us within five days after acceptance by us for the Funds of your order. If such payment is not so received we reserve the right, without notice, forthwith to cancel the sale, and we may hold you responsible for any loss, including loss of profit, suffered by us or by the Funds resulting from your failure to make such payment.

10. No person is authorized to make any representations concerning shares of the Funds except those contained in the then current Prospectus of each of the Funds and in printed information subsequently issued by each of the Funds as information supplemental to such Prospectus. In all sales of these shares to the public you shall act as dealer for your own account, and in no transaction shall you have any authority to act as agent for the Funds for us or for any other member of the Selling Group. In purchasing shares from us you shall rely solely on the representations contained in the Prospectus of each of the Funds concerned and supplemental information above mentioned.

11. Additional copies of the then current Prospectus for each of the Funds and any printed information issued as supplemental to such Prospectus will be supplied by us in reasonable quantities upon request.

12. The Funds reserve the right in their own discretion, without notice, at any time and from time to time, to suspend sales or withdraw the offering of shares entirely. We reserve the right to amend this Agreement, and to reject in whole or in part any order received by us from you. Either party hereto may cancel this Agreement at any time. All purchase orders received by us will be subject to receipt of shares by us from the Fund concerned.

13. Each of us hereby represents and agrees that each of us is and will continue to be during the life of this Agreement a member of the National Association of Securities Dealers, Inc., or that we are a foreign dealer and we are not eligible for membership in said Association, and in any event we both hereby agree to abide by the Rules of Fair Practice of that Association.

14. All communications to us should be sent to the above address. Any notice to you shall be duly given if mailed or telegraphed to you at the address specified by you below. This Agreement shall be construed in accordance with the laws of Pennsylvania.

15. Your first order placed with us for the purchase of shares of any of the Funds will represent your acceptance of this Agreement.

WELLINGTON MANAGEMENT COMPANY
By William G. Gallagher
Senior Vice President—Sales

Please return one signed copy of this agreement to:
Wellington Management Company
Order Department
1630 Locust Street
Philadelphia, Pa. 19103

Accepted:

Firm Name: ....
By: ....
Address: ....
....
Date: ....

(Title Omitted in Printing)

ANSWER OF THE DEFENDANT VANCE, SANDERS & COMPANY, INC.

1. The defendant Vance, Sanders & Company, Inc. ("the defendant") admits that the action purports to be brought under section 4 of the Act of Congress of July 2, 1890 commonly known as the Sherman Act, 15 U.S.C. § 4, to restrain alleged continuing violations of section 1 of said Act, 15 U.S.C. § 1, but denies that the action can be so maintained.

2. The defendant admits that it presently has an office in the District of Columbia and that the defendant Massachusetts Investors Growth Stock Fund, Inc. does not transact business, and is not found, therein. The defendant is without information sufficient to form a belief as to the truth or falsity of the other allegations of paragraph 2 of the Complaint.

3. Paragraph 3 of the Complaint does not call for any answer. The defendant further says that it does not accept as correct the definitions in paragraph 3 of the Complaint.

4. The defendant is without information sufficient to form a belief as to the truth or falsity of the allegations of paragraph 4 of the Complaint.

5. The defendant admits the allegations of the first sentence of paragraph 5 of the Complaint. The defendant admits that it is presently the principal underwriter of the mutual funds listed in paragraph 5 of the Complaint and says that said mutual funds presently have combined net assets in excess of $3.7 billion. Further answering the allegations of paragraph 5 of the Complaint, the defendant says that after June 30, 1973, it will no longer act as principal underwriter for Massachusetts Investors Growth Stock Fund, Inc., Massachusetts Investors Trust, Massachusetts Income Development Fund, Massachusetts Capital Development Fund and Massachusetts Financial Development Fund and that it does not accept the characterization of any of the funds listed in paragraph 5 of the Complaint as the "Vance Sanders Funds".

6. The defendant is without information sufficient to form a belief as to the truth or falsity of the allegations of paragraph 6 of the Complaint.

7. The defendant is without information sufficient to form

a belief as to the truth or falsity of the allegations of paragraph 7 of the Complaint.

8. The defendant admits the allegations of the first and third sentences of paragraph 8 of the Complaint. The defendant is without information sufficient to form a belief as to the truth of falsity of the allegations of the second sentence of paragraph 8 of the Complaint.

9. The defendant admits the allegations of the first sentence of paragraph 9 of the Complaint. The defendant admits that shares of the mutual funds for which it acted as principal underwriter as of February 21, 1973 ("the Vance Sanders underwritten funds") are continuously issued and redeemed by said mutual funds, that the shares of the Vance Sanders underwritten funds are presently distributed through the defendant which presently has the exclusive contractual right to distribute said shares to dealers for resale and that the defendant enters into selling group agreements with broker-dealers which sell shares of the Vance Sanders underwritten funds to investors, the current form of which selling group agreement is attached hereto and incorporated herein marked "A". The defendant is otherwise without information sufficient to form a belief as to the truth or falsity of the allegations of the second, third and fourth sentences of paragraph 9 of the Complaint. The defendant denies the allegations of the fifth sentence of paragraph 9 of the Complaint. The sixth sentence of paragraph 9 of the Complaint is a conclusion of law which the defendant is not required to answer. The defendant admits that some mutual fund shares are purchased, sold and redeemed in interstate commerce. The defendant is otherwise without information sufficient to form a belief as to the truth or falsity of the allegations of the seventh sentence of paragraph 9 of the Complaint. The defendant is without information sufficient to form a belief as to the truth or falsity of the allegations of the eighth sentence of paragraph 9 of the Complaint.

10. The defendant is without information sufficient to form a belief as to the truth or falsity of the allegations of paragraph 10 of the Complaint.

11. The defendant admits that the public offering prices of the Vance Sanders underwritten funds, as described in the prospectuses thereof, are based on net asset values plus sales charges, the maxima of which are presently 8.5% of

the public offering prices for purchases of less than $12,500 (less on larger purchases), and that the Vance Sanders underwritten funds redeem their outstanding shares, upon presentation for redemption, at the then current net asset values. The defendant is otherwise without information sufficient to form a belief as to the truth or falsity of the allegations of paragraph 11 of the Complaint.

12. The defendant admits that, when a share of a Vance Sanders underwritten fund is sold, the defendant presently retains a portion of the sales charge which is usually 2.0% when the sales charge is 8.5% (less when the sales charge is less). The defendant is otherwise without information sufficient to form a belief as to the truth or falsity of the allegations of the first sentence of paragraph 12 of the Complaint. The defendant is without information sufficient to form a belief as to the truth or falsity of the allegations of the second and third sentences of paragraph 12 of the Complaint.

13. Answering the allegations of paragraph 13 of the Complaint, the defendant says that section 22(d) of the Investment Company Act is codified as 15 U.S.C. § 80a-22(d) and is in writing and, read in conjunction with its history and all other relevant and pertinent interpretive material, speaks for itself. And further answering the allegations of paragraph 13 of the Complaint, the defendant says that neither as enacted in 1940, nor as amended in 1970, has section 22(d) of the Investment Company Act ever contained the alleged provision "engaged in a dealer transaction" which the plaintiff now gratuitously interpolates into the statute.

14. The allegations of paragraph 14 of the Complaint are legal conclusions which the defendant is not required to answer.

15. The defendant denies the allegations of paragraph 15 of the Complaint.

16. The defendant denies the allegations of paragraph 16 of the Complaint.

17. Answering the allegations of paragraph 17 of the Complaint, the defendant says that he rules of the NASD have always been on file with the Securities and Exchange Commission and have always been readily available to interested members of the public and are in writing and speak for themselves and that this is not the proper forum or

type of proceeding for an attack by the plaintiff on rules promulgated pursuant to authority conferred by the Congress of the United States and under the supervision of the Securities and Exchange Commission. Otherwise the defendant denies the allegations of paragraph 17 of the Complaint.

18. The defendant denies the allegations of paragraph 18 of the Complaint.

19-30. The defendant is not made a defendant in Count II or Count III of the Complaint and is therefore not called upon to answer the allegations of paragraphs 19 through 30 inclusive of the Complaint.

31. The defendant admits that it is made a defendant in Count IV of the Complaint and further answering the allegations of paragraph 31 of the Complaint restates the averments of paragraph 5 of this Answer with the same force and effect as if herein set forth and repeated in full.

32. The defendant admits that the so-called defendant broker/dealers are made defendants in Count IV of the Complaint and further answering the allegations of paragraph 32 of the Complaint restates the averments of paragraph 7 of this Answer with the same force and effect as if herein set forth and repeated in full.

33. The defendant restates the averments of paragraphs 9 through 14 inclusive of this Answer with the same force and effect as if herein set forth and repeated in full.

34. The defendant denies the allegations of paragraph 34 of the Complaint.

35. The defendant says that the current form of its selling group agreement is attached hereto and incorporated herein marked "A" and is in writing and speaks for itself. Except as averred, the defendant denies the allegations of paragraph 35 of the Complaint.

36. The defendant denies the allegations of paragraph 36 of the Complaint.

37. The defendant admits that Massachusetts Investors Growth Stock Fund, Inc. ("MIGS") is made a defendant in Count V of the Complaint, that MIGS is a corporation organized under the law of the Commonwealth of Massachusetts, that MIGS is an open-end management type investment company commonly known as a mutual fund, that as of February 21, 1973, MIGS had net assets in excess of $1.2 billion and that in the fiscal year ended November

30, 1970 approximately $69.9 million of treasury or newly issued MIGS shares were sold to investors. The defendant is without information sufficient to form a belief as to the truth or falsity of the other allegations of paragraph 37 of the Complaint.

38. The defendant admits that it is made a defendant in Count V of the Complaint and further answering the allegations of paragraph 38 of the Complaint restates the averments of paragraph 5 of this Answer with the same force and effect as if herein set forth and repeated in full.

39. The defendant restates the averments of paragraphs 9 through 14 inclusive of this Answer with the same force and effect as if herein set forth and repeated in full.

40. The defendant denies the allegations of paragraph 40 of the Complaint.

41. The defendant admits that, pursuant to its agreements with the Vance Sanders underwritten funds, it presently acts as principal for its own account in the sale of shares of said funds to dealers. Except as expressly admitted, the defendant denies the allegations of paragraph 41 of the Complaint.

42. The defendant denies the allegations of paragraph 42 of the Complaint.

43-59. The defendant is not made a defendant in Count VI, Count VII or Count VIII of the Complaint and is therefore not called upon to answer the allegations of paragraphs 43 through 59 inclusive of the Complaint.

Second Defense

The Complaint and each of Counts I, IV and V thereof fails to state a claim on which relief can be granted.

Third Defense

Any acts of the defendant and the other defendants which are the subject matter of the Complaint were authorized by the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*, by the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*, and by the Securities and Exchange Commission acting with the powers conferred upon it by said Acts and as so authorized do not constitute a violation of any of the laws of the United States.

Fourth Defense

The Congress of the United States has delegated exclusive authority and administrative supervision over the matters alleged in the Complaint to the Securities and Exchange Commission to the exclusion of the jurisdiction of the courts of the United States including this Court.

WHEREFORE, the defendant prays that the Complaint be dismissed and for its costs.

VANCE, SANDERS & COMPANY, INC.
By its attorneys,

Herbert J. Miller, Jr.
Miller, Cassidy, Larroca & Lewin
Suite 500
1320 19th Street, N.W.
Washington, D.C. 20036
Telephone 293-6400

OF COUNSEL:
George C. Caner, Jr.
John Silas Hopkins, III
Ropes & Gray
225 Franklin Street
Boston, Massachusetts 02110
Telephone 617-423-6100

March 26, 1973

Exhibit A To Answer of Defendant Vance, Sanders & Co.

Vance, Sanders & Company, Inc.
111 Devonshire Street
Boston 02109

Boston Fund
Boston Common Stock Fund
Century Shares Trust
Massachusetts Capital Development Fund
Massachusetts Financial Development Fund
Massachusetts Income Development Fund
Massachusetts Investors Growth Stock Fund
Massachusetts Investors Trust
Vance, Sanders Special Fund

Dear Sirs:

We are the Principal Underwriter of the shares of Boston Fund, Inc., Boston Common Stock Fund, Inc., Century Shares Trust, Massachusetts Capital Development Fund, Inc., Massachusetts Financial Development Fund, Inc., Massachusetts Income Development Fund, Inc., Massachusetts Investors Growth Stock Fund, Inc., Massachusetts Investors Trust and Vance, Sanders Special Fund, Inc. and, as such, have the exclusive right to distribute shares of these Funds for resale. As principal, we offer to sell to you, as a member of the Selling Group, shares of each of these Funds upon the following terms and conditions:

1. In all sales of these shares to the public you shall act as dealer for your own account, and in no transaction shall you have any authority to act as agent for the issuer, for us or for any other member of the Selling Group.

2. Orders received from you will be accepted through us only at the public offering price applicable to each order, as established by the then current Prospectus of the Fund for whose shares the order is placed. The procedure relating to the handling of orders shall be subject to instructions which we shall forward from time to time to all members of the Selling Group. All orders are subject to acceptance or rejection by us in our sole discretion.

3. For a schedule of the offering prices of the shares of each of the Funds and of your discount with respect to the sale of shares of each of the Funds see the reverse side hereof. The term "single transaction" shall have the same

meaning as set forth in the current Prospectus of each Fund.

4. You agree to purchase shares only through us or from your customers other than dealers or brokers. If you purchase shares through us, you agree that all such purchases shall be made only to cover orders already received by you from your customers, or for your own bona fide investment. If you purchase shares from your customers, you agree to pay such customers not less than the bid price quoted by us as agent for the issuer at the time of such purchase.

5. You shall sell shares only

(a) to customers at the public offering price then in effect.

(b) to us or the Fund upon the terms and conditions set forth in the current Prospectus of each Fund. In such a sale, you may act either as principal for your own account or as agent for your customer. If you act as agent for your customer in selling shares, you agree not to charge your customer more than a fair commission for handling the transaction.

6. You shall not withhold placing through us orders received from your customers so as to profit yourself as a result of such withholding: e.g., by a change in the "net asset value" from that used in determining the offering price to your customers.

7. We will not accept from you any conditional orders or shares, except at a definite specified price.

8. If any shares sold to you under the terms of this agreement are repurchased by the issuer or by us as agent for any such Fund or are tendered for redemption, within seven business days after the date of our confirmation of the original purchaser by you, it is agreed that you shall forfeit your right to any discount received by you on such shares.

We will notify you of any such repurchase or redemption within ten business days from the date on which the certificate is delivered to us or to the issuer, and you shall forthwith refund to us the full discount allowed to you, and we agree to pay such refund forthwith to the issuer.

9. Payment for shares ordered from us shall be in New York or Boston clearing house funds received by us within

five days after our acceptance of your order. If such payment is not received by us, we reserve the right, without notice, forthwith to cancel the sale, or, at our option, to sell the shares ordered back to the issuer, in which latter case we may hold you responsible for any loss, including loss of profit, suffered by us resulting from your failure to make payment as aforesaid.

10. Shares sold to you hereunder shall be available to you for delivery against payment at the office of our agent, the New England Merchants National Bank, Mutual Funds Clearance Department, Boston, Massachusetts, unless other arrangements are made with us for delivery and payment.

11. No person is authorized to make any representations concerning shares of the issuer except those contained in the current Prospectus and in such printed information subsequently issued by us as information supplemental to such Prospectus. In purchasing shares through us you shall rely solely on the representations contained in the appropriate Prospectus and supplemental information above mentioned. Qualification of the shares of Boston Fund, Inc., Boston Common Stock Fund, Inc., Century Shares Trust, Massachusetts Capital Development Fund, Inc., Massachusetts Financial Development Fund, Inc., Massachusetts Income Development Fund, Inc., Massachusetts Investors Growth Stock Fund, Inc., Massachusetts Investors Trust and Vance, Sanders Special Fund, Inc. in the various states, including the filing of any state or further state notices respecting such shares, and any printed information which we furnish you other than the Funds' Prospectuses and periodic reports are our sole responsibility and not the responsibility of the respective Funds, and you agree that these Funds shall have no liability or responsibility to you in these respects.

12. Additional copies of any current Prospectus and any printed information issued as supplemental to such Prospectus will be supplied by us in reasonable quantities upon request.

13. We reserve the right in our discretion, without notice, to suspend sales or withdraw the offering of shares entirely. Each party hereto has the right to cancel this agreement upon notice to the other party.

14. You represent that you are a member of the National

Association of Securities Dealers and we both hereby agree to abide by the Rules of Fair Practice of such Association.

15. All communications to us should be sent to the above address. Any notice to you shall be duly given if mailed or telegraphed to you at the address specified by you below. This agreement shall be construed in accordance with the laws of Massachusetts.

16. This agreement supersedes and cancels any prior agreement with respect to the sale of shares of any of the aforementioned Funds.

17. You appoint the transfer agent for each Fund as your agent to execute the purchase transactions of shares of each Fund in accordance with the terms and provisions of any account, program, plan or service established or used by your customers and to confirm each purchase to your customers on your behalf, and you guarantee the legal capacity of your customers so purchasing such shares and any co-owners of such shares.

NOTE: The term "net asset value" as used in paragraphs 5 and 6 and on the schedule "Offering Prices" means "liquidating value" in the case of Boston Fund and Century Shares Trust.

VANCE, SANDERS & COMPANY, INC.
By John D. Wilson
President

Dated ....

The undersigned hereby accepts the offer set forth in the above letter.

Firm ....
By ....
Authorized Representative
Address ....

Offering Prices

In single transactions by you of shares of Boston Fund, Boston Common Stock Fund, Century Shares Trust, Massachusetts Capital Development Fund, Massachusetts Financial Development Fund, Massachusetts Income Development Fund, Massachusetts Investors Growth Stock Fund, Massachusetts Investors Trust or Vance, Sanders Special Fund involving: (1) less than $12,500, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .915, in each case determined in the manner and as of the time specified in the Prospectus; (2) $12,500 but less than $25,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .925; (3) $25,000 but less than $50,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9425; (4) $50,000 but less than $100,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .96; (5) $100,000 but less than $250,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9675; (6) $250,000 but less than $500,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .975; (7) $500,000 but less than $1,000,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9775; and (8) $1,000,000 or more, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9825.

Dealer Discounts

On the purchase of shares by you to cover a single transaction involving: (1) less than $12,500, you shall receive a discount from the applicable public offering price of 6.50% with respect to shares of Boston Fund, Boston Common Stock Fund, Century Shares Trust, Massachusetts Capital Development Fund, Massachusetts Financial Development Fund, Massachusetts Income Development Fund, Massachusetts Investors Growth Stock Fund, Massachusetts Investors Trust and Vance, Sanders Special Fund, except that

in supplementary purchases of shares of any of these Funds under the invest-by-mail program, you shall receive a discount from the applicable public offering price of 6.00% (except that on Dividend Reinvestments only, discounts of less than $5 will not be paid); (2) $12,500 but less than $25,000, you shall receive a discount from the applicable public offering price of 6.00%; (3) $25,000 but less than $50,000, you shall receive a discount from the applicable public offering price of 4.25%; (4) $50,000 but less than $100,000, you shall receive a discount from the applicable public offering price of 3.00%; (5) $100,000 but less than $250,000, you shall receive a discount from the applicable public offering price of 2.50%; (6) $250,000 but less than $500,000, you shall receive a discount from the applicable public offering price of 2.00%; (7) $500,000 but less than $1,000,000, you shall receive a discount from the applicable public offering price of 1.75% and (8) $1,000,000 or more, you shall receive a discount from the applicable public offering price of 1.25%.

December 29, 1972

AMENDMENT TO SELLING GROUP AGREEMENT

To Selling Group Members:

Effective today, the name of Boston Common Stock Fund is changed to Vance, Sanders Common Stock Fund. Accordingly, we wish to advise you that the present Selling Group Agreement between our firms is amended to reflect this name change in the following paragraphs:

(1) The initial paragraph of the Agreement which lists the group of Funds for which we are the underwriter.
(2) The third sentence of paragraph 11 of the Agreement.
(3) The two paragraphs on the reverse side of the Agreement headed "Offering Prices" and "Dealer Discounts."

In place of your signing and returning a duplicate copy of this revision of the Selling Group Agreement, we will consider your first order on or after December 29, 1972 as acceptance of this revision.

This amendment to the Selling Group Agreement should be attached to your file copy of the Agreement inasmuch as it is part of the Agreement as of the date hereof.

VANCE, SANDERS & COMPANY, INC.
By John D. Wilson
JOHN D. WILSON
President

(Certificate of Service Omitted in Printing)

(Title Omitted in Printing)

ANSWER OF DEFENDANT WELLINGTON MANAGEMENT COMPANY, INC.

Comes now Wellington Management Company, Inc. named as one of the defendants in the above styled case, and answers and responds to the complaint as follows:

First Defense

The complaint fails to state a claim against the defendant upon which relief can be granted.

Second Defense

The alleged unlawful activities of this defendant were required by the Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq.*, the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.*, and rules and regulations adopted pursuant to such Acts, and are exempt from the prohibitions of the antitrust laws.

Third Defense

The Court lacks jurisdiction over the subject matter of the complaint and the person of the defendant.

Fourth Defense

1.

With respect to the section of the complaint entitled "Jurisdiction and Venue" this defendant admits that the complaint purports to seek relief under § 4 of the Sherman Act (15 U.S.C. § 4), admits that Wellington Fund, Inc. is not found and does not transact business in the District of Columbia, and is without knowledge or information sufficient to form a belief as to whether the other defendants are found or transact business in the District of Columbia.

2.

With respect to the section of the complaint entitled "Definitions," this defendant admits the definitions con-

tained in paragraph 3(a)-(e) and denies the statement of the definitions contained in paragraphs 3(f)-(h).

3.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 4 and 5 of the complaint.

4.

This defendant admits the allegations contained in paragraph 6 of the complaint.

5.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 7 and 8 of the complaint.

6.

This defendant admits that it acts as principal underwriter for the seven open-end management investment companies listed in paragraph 6 of the complaint (which investment companies are registered with the Securities and Exchange Commission under the Investment Company Act of 1940) pursuant to an underwriting agreement, a specimen copy of which is attached hereto as Exhibit A, and which is filed with the Securities and Exchange Commission as required by the Investment Company Act of 1940 and regulations issued thereunder. This defendant also admits that it has existing sales agreements with each of the defendants named in paragraph 7 of the complaint relating to the sale of shares of each of the registered open-end management investment companies for which it acts as principal underwriter, a specimen copy of which is attached hereto as Exhibit B, and specimens of which are on file with the Securities and Exchange Commission as required by the Investment Company Act of 1940 and regulations issued thereunder. The underwriting agreement referred to above is the only agreement relating to the sale of such shares between this defendant and the registered open-end companies referred to in paragraph 6 of the complaint. The sales agreement referred to above is

the only agreement referring to the sales of the shares of such registered companies between this defendant and the broker-dealers named in paragraph 7 of the complaint. This defendant also admits that the registered open-end management investment companies for which it acts as principal underwriter must redeem their shares in accordance with the provisions of the Investment Company Act of 1940. Other than as stated above, this defendant denies, or is without information sufficient to form a belief as to the truth of the allegations contained in paragraph 9.

7.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 10 of the complaint.

8.

With respect to the allegations of paragraphs 11 and 12 of the complaint, this defendant admits that shares of the registered open-end management investment companies for which it acts as principal underwriter are normally sold at an offering price described in the prospectus as required by § 22(d) of the Investment Act of 1940, and set forth in the sales agreement attached hereto as Exhibit B. Except as stated above this defendant either denies or is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 11 and 12 of the complaint.

9.

With respect to paragraphs 13 and 14 of the complaint, this defendant avers that the allegations contained therein constitute conclusions of law incapable of being either admitted or denied. To the extent such allegations may be deemed to be allegations of material fact they are denied.

10.

This defendant denies the allegations contained in paragraphs 15, 16, 17 and 18 of the complaint.

11.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 19, 20, 22, 23 and 24. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 21 of the complaint.

12.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 25, 26, 28, 29 and 30. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 27 of the complaint.

13.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 31, 32, 34, 35 and 36. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 33 of the complaint.

14.

This defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 37, 38, 40, 41 and 42. This defendant reasserts its response in paragraphs 6 through 9 of this Fourth Defense to the allegations contained in paragraph 39 of the complaint.

15.

With respect to the allegations contained in paragraphs 43 through 48 of the complaint this defendant reasserts its response contained in paragraphs 6 through 9 of this Fourth Defense. Except as stated above, this defendant denies the allegations contained in paragraphs 43 through 48.

16.

This defendant admits the allegations of paragraph 49.

17.

With respect to the allegations contained in paragraphs 50 through 54 of the complaint, this defendant reasserts its response contained in paragraphs 6 through 9 of this Fourth Defense. Except as stated above this defendant denies the allegations contained in paragraphs 50 through 54 of the complaint.

18.

With respect to the allegations contained in paragraphs 55, 57 through 59 of the complaint, defendant admits that it has in effect sales agreements with the broker-dealers named in paragraph 7 of the complaint, a specimen copy of which is attached as Exhibit B. This defendant reasserts its response contained in paragraphs 6 through 9 of this Fourth Defense in response to the allegations of paragraph 56 of the complaint. Except as stated above, this defendant denies the allegations contained in paragraphs 55 through 59.

WHEREFORE, this defendant files its answer to the plaintiff's complaint and prays that the complaint be dismissed.

By Robert E. Jensen
ROBERT E. JENSEN

By W. L. Dickey
WILLIAM L. DICKEY
WILLIAMS & JENSEN
Attorneys for Defendant
Wellington Management Company, Inc.
Suite 620, 1130 17th Street, N.W.
Washington, D.C. 20036
Tel. (202) 223-6150

OF COUNSEL:
Richard M. Phillips
Hill, Christopher & Phillips
2000 L Street, N.W.
Washington, D.C. 20036
Tel. (202) 833-3990

(Certificate of Service Omitted in Printing)

EXHIBIT A

UNDERWRITING AGREEMENT

THIS AGREEMENT, by and between WELLINGTON FUND, INC. a corporation organized and existing under the laws of the State of Maryland (hereinafter called "FUND") and WELLINGTON MANAGEMENT COMPANY, a corporation organized and existing under the laws of the State of Delaware (hereinafter called "COMPANY"):

WITNESSETH:

WHEREAS, FUND is an open-end investment company registered under the Investment Company Act of 1940, the shares of which are registered under the Securities Act of 1933, and is desirous of issuing to the general public all of its now or hereafter authorized, but unissued, shares of capital stock and/or shares of capital stock now or later held in its Treasury; and

WHEREAS, COMPANY is interested in promoting the growth of FUND and will be equipped financially and with qualified personnel and extensive facilities to encourage the sale of shares of FUND by investment dealers and to create and provide the sales literature, advertising and other sales promotional aids necessary to accomplish such growth.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto hereby covenant and agree to and with each other as follows:

1. (a) COMPANY agrees to act as the principal underwriter and exclusive national distributor for the shares of FUND and will, upon receipt of unconditional orders from investment dealers or investors (and not before), transmit such bids or orders as agent for FUND for acceptance and confirmation by FUND to its principal office as FUND may from time to time direct. The price at which shares of FUND are offered to the public through COMPANY shall be computed and shall be effective as set forth in the Prospectus of FUND current as of the time of such sale.

(b) FUND reserves the right to reject any order, provided, however, that FUND does hereby covenant and agree that it will not arbitrarily or without reasonable cause refuse acceptance or confirmation of orders obtained and

submitted under this Agreement for the purchase of shares of stock of FUND and, upon receipt thereof, will in all proper cases confirm orders directly through the COMPANY as agent for FUND or authorize the COMPANY, as agent for FUND, to deliver proper confirmations and, if requested, will deliver certificates for shares so purchased to COMPANY as soon as practicable after receipt of payment therefore in cash.

(c) COMPANY agrees that it will not directly or indirectly withhold orders for the purchase of stock of FUND or purchase stock of FUND in anticipation of orders, and does further agree that in all contracts or arrangements with dealers or distributors acting under or through it, it will require a similar contractual undertaking. COMPANY further agrees that it will arrange for the purchase of shares of FUND only from FUND, except when acting as agent for FUND on repurchase of shares under Paragraph 2 hereof.

2. Sales of FUND's shares under this Agreement shall be handled by COMPANY as agent for FUND. With FUND's consent, COMPANY may also act as agent for FUND without commission on repurchase of shares of FUND. Except for such sales and repurchase of shares of FUND, COMPANY shall act as principal in all other matters relating to promotion of the growth of FUND and shall enter into all of its engagements, agreements and contracts as principal on its own account. Furthermore, this Agreement shall not be construed as authorizing any dealer or other person to act as agent, either of FUND or of COMPANY.

3. FUND covenants and agrees that it will, at its own expense:

(a) use its best efforts to keep authorized, but unissued, sufficient of its capital stock to meet the reasonable requirements of COMPANY;

(b) execute or cause to be executed all documents requiring signatures of FUND necessary to permit COMPANY to comply with the provisions of Paragraph 4 hereof;

(c) supply COMPANY with the "net asset value per share" computed as at the time(s) prescribed by and in compliance with all pertinent requirements of the National Association of Securities Dealers and the Securities and Exchange Commission, so as to permit COMPANY to comply with the provisions of Paragraph 4 hereof.

4. COMPANY covenants and agrees that it will, at its own expense:

(a) prepare, file and keep effective registration statements, prospectuses and licenses covering so many shares of stock of FUND as may be necessary to meet COMPANY's reasonable requirements for distribution and sale of such shares in all jurisdictions where shares of FUND may lawfully be sold;

(b) prepare as often as, and at the specific times, required by appropriate authority on each business day for publication in newspapers or other financial publications both the offering price to the public and the liquidation price of FUND shares;

(c) prepare, print and distribute (subject to the provisions of Paragraph 5 hereof) all advertising and sales literature relating to FUND.

5. (a) COMPANY does hereby covenant and agree that it will not issue any statements other than FUND's properly approved Prospectus, except such supplemental literature or advertising (prepared at the expense of COMPANY) as shall be lawful under state and federal securities laws and regulations and under applicable laws and regulations of foreign jurisdictions. COMPANY agrees to file with the Securities and Exchange Commission, the National Association of Securities Dealers, Inc. and such other regulatory authorities as may be required, copies of any advertisement, pamphlet, circular, form letter, or other sales literature relating to FUND or its shares, addressed to or intended for distribution to prospective investors, within the time required by such regulatory authorities, to furnish FUND at its principal office with a copy of all such material prior to its use and not to use such material if the FUND shall reasonably and promptly object to such use.

(b) COMPANY shall conform to all applicable By-Laws, charter provisions, and regulations to which FUND is subject and to applicable laws and regulations of the United States and of the individual states within which COMPANY or FUND may do business, or where shares of FUND are offered for sale, and will conduct its affairs both with relation to FUND and with relation to dealers, or investors, in accordance with the rules of fair practice of the National Association of Securities Dealers, Inc. COMPANY shall also comply with applicable laws and regulations of foreign

jurisdictions in which shares of FUND or securities of an investment company using shares of FUND as its sole underlying investment are offered.

(c) COMPANY agrees to indemnify and hold harmless FUND and each person who has been, is, or may hereafter be an officer or director of FUND against expenses reasonably incurred by any of them in connection with any claim or in connection with any action, suit or proceeding to which any of them may be a party, which arises out of, or is alleged to arise out of any wrongful act of COMPANY or its employees or any misrepresentation in the registration statement of FUND filed under the Securities Act of 1933 of a material fact, or out of any alleged omission to state therein a material fact necessary to make the statements made therein not misleading, insofar as any such statement or omission was made in reliance upon, and in conformity with, information furnished to FUND in connection therewith by, or in behalf of COMPANY, provided, however, that (i) in no case is the indemnity of COMPANY in favor of FUND or any person indemnified to be deemed to protect FUND or any such person against any liability to which FUND or any such person would otherwise be subject by reason of willful misfeasance, bad faith or gross negligence, in the performance of its duties or by reason of its reckless disregard of its obligation and duties under this agreement, and (ii) in no case is COMPANY to be liable under its indemnity agreement contained in this paragraph with respect to any claim made against FUND or any person indemnified, unless FUND or such person, as the case may be, shall have notified COMPANY in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon FUND or upon such person (or after FUND or such person shall have received notice of such service on any designated agent). In the case of any such notice to COMPANY, COMPANY shall be entitled to participation, at its own expense, in the defense of any suit brought to enforce any such liability. COMPANY agrees promptly to notify FUND of the commencement of any litigation or proceedings against it in connection with the issue and sale of any of the shares. The term "expenses" includes amounts paid in satisfaction of judgments or in settlement. The foregoing right of indemnification shall be in addition to any other rights to

which FUND or any such officer or director may be entitled as a matter of law.

6. FUND covenants and agrees that it will not, during the term of this Agreement offer any of its shares for sale directly or through any person or corporation other than COMPANY, excepting only (a) the issuance of rights to stockholders to subscribe to shares to the extent of all or part of any dividend that may be distributed to stockholders of FUND or to the extent of any shares that may be taken up under an optional or alternative dividend, or the issuance of additional shares through stock splits or stock dividends, and (b) sales of shares to another investment or securities holding company in the process of converting all or a portion of its assets into shares of FUND or in connection with an issuance of FUND's shares in exchange for shares of another investment or securities holding company, to the extent permitted by the Investment Company Act of 1940, as from time to time amended. Provided, however, that in the event COMPANY should be unable to continue to distribute shares of FUND and such restriction shall not apply to the sale of shares of FUND by any other person, FUND may at its option make arrangements for the offer and sale of its shares within the jurisdiction or jurisdictions in which distribution and sale thereof by COMPANY has been prevented, provided, further however, that if COMPANY shall have removed all material obstacles to resuming the offer and sale within said jurisdictions within ninety days from its first restraint or inability, then the right of FUND to distribute through instrumentalities other than COMPANY shall be extinguished, subject only to the provisions of Paragraph 8 hereof. FUND further agrees that COMPANY may act as principal underwriter and exclusive national distributor for the shares of other investment companies registered under Investment Company Act of 1940. FUND and COMPANY further agree that the shares of the FUND may be sold through COMPANY as agent for the FUND to any investment company which uses the shares of the FUND as its sole underlying investment, provided that such other investment company is sponsored by the COMPANY (or, if a United States investment company, sponsored by a distributor approved by the COMPANY), or by a wholly-owned subsidiary of the COMPANY and, provided further, that if such investment company is organized under

the laws of the United States or is designed to permit its securities to be sold to United States citizens or residents, it shall additionally register under the Investment Company Act of 1940, as from time to time amended.

7. It is hereby mutually agreed that COMPANY in full satisfaction of all services herein agreed to be performed by it shall receive a commission not to exceed 8½% of the offering price of all shares of FUND sold by it after the effective date hereof; provided, however, that the commission payable on separate volume and other special transactions shall be as from time to time set forth in the Prospectus of FUND then in effect, provided further that, if the Prospectus of the FUND so specifies, COMPANY shall receive no commission on sales of shares of FUND at net asset value to those persons described and on the terms provided in Rule 22d-1(h) promulgated under the Investment Company Act of 1940, as amended. The commissions aforesaid shall become due and owing immediately upon settlement for any sale made through COMPANY and COMPANY shall deduct such commissions from any remittance to FUND, provided, however, that if change is required in the aforesaid commissions, either by duly constituted regulatory authorities, or for business reasons, the amount payable to FUND from the sale of shares shall always equal the then current net asset value per share. COMPANY agrees that, if shares are repurchased by FUND or by COMPANY as agent for FUND, or are tendered to FUND for redemption within seven days after confirmation by COMPANY, as agent, of the original purchase order to any broker or dealer originating such transaction, COMPANY will immediately remit to FUND the commission (net of allowances of dealers or brokers) on such sale paid to COMPANY and will promptly, upon receipt thereof, pay to FUND any refunds of the balance of sales commissions repaid to COMPANY by brokers or dealers. Notwithstanding the foregoing, all sales of shares of FUND to any investment company in accordance with the provisions of Paragraph 6 of this Agreement as amended shall be made through COMPANY at net asset value, and no commissions shall be charged to, or paid by, such investment company with respect to such shares.

8. This Agreement shall become effective on April 1, 1973, and shall continue in force until March 31, 1975, and thereafter, only so long as such continuance is approved at

least annually thereafter by a vote of the Fund's Board of Directors, including the votes of a majority of the directors who are not parties to such Contract or interested persons of any such party, cast in person at a meeting called for the purpose of voting such approval.

9. Subject to the provisions of the immediately preceding paragraph, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors, provided, however, that this Agreement shall terminate automatically upon assignment by COMPANY as provided for and defined in the Investment Company Act of 1940 as amended, unless under the exemptive provisions of Section 6(c) of such Act, the Securities and Exchange Commission shall determine that a conditional or unconditional order of exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purpose fairly intended by the policy and practice of such Act; in which event this Agreement shall continue in full force and effect.

10. In the event that this Agreement, or any part thereof, shall become unlawful under any future law of the United States, or any state, territory, possession or district thereof, or any regulations of the United States, any state, territory, possession and district thereof, or any department, board or commission or other governmental authority having jurisdiction over its performance, such unlawful portion of the Agreement shall be considered as though it were deleted by mutual consent; but the remaining provisions of the Agreement shall not cease and terminate and the parties hereto shall confer and attempt to agree to such change or modification in the said Agreement as will cause it to conform to said law or regulation and will maintain the general purpose and provisions of this Agreement in a manner equitable to each of the parties hereto. If, in such event, the parties hereto are unable to agree with respect to the said modification, each shall promptly appoint one arbitrator and the two arbitrators so appointed shall appoint a third arbitrator, who shall consider all the facts and circumstances relating to this Agreement and to the necessary modification thereof to comply with such future law or regulation, and if, in the opinion of said arbitrators, or a majority of them, a modification of the said Agreement may be made which will comply with the said new law or regula-

tion and will maintain the general purposes of this Agreement and be fair and equitable to both of the parties hereto, they shall direct in what particulars this Agreement shall be modified and amended, and upon the receipt by each of the parties hereto of the written report of the arbitrators, the Agreement shall thereupon be deemed to be altered and amended as provided in the said report and as so altered and amended shall continue to be effective and binding on both of the parties hereto. The provisions of this Paragraph 10 shall be administered in accordance with provisions of the Act of Assembly of the Commonwealth of Pennsylvania, enacted April 25, 1927, P.L., 381 Number 248, as amended. Provided, however, that neither FUND, nor COMPANY, shall be bound to accept the directions of the arbitrators if the modification or amendment of the Agreement stated in the Arbitrators' written report would, in the opinion of counsel for FUND, require approval under the provisions of Section 15(c) of the Investment Company Act of 1940, as amended, and provided further that FUND reserves the right in the event of any award or decision by the arbitrators to call a special meeting of the stockholders of the FUND and to submit to the vote of the stockholders the question of whether the recommendations of the arbitrators shall or shall not be adopted by and binding upon the FUND, in which case the decision of the stockholders shall be final and binding upon FUND and COMPANY.

11. It is the intention of the parties hereto that this Agreement shall be governed and construed according to the laws of the Commonwealth of Pennsylvania.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective duly authorized officers and to have hereunto affixed their respective corporate seals this First day of April, 1973.

Attest: WELLINGTON FUND, INC.

By:

Secretary *President*

Attest: WELLINGTON MANAGEMENT COMPANY

By:

Secretary *President*

EXHIBIT B

WELLINGTON MANAGEMENT COMPANY
1630 LOCUST STREET • PHILADELPHIA, PA. 19103

Sales Agreement

with respect to

WELLINGTON FUND WINDSOR FUND IVEST FUND W. L. MORGAN GROWTH FUND WELLESLEY INCOME FUND EXPLORER FUND TRUSTEES' EQUITY FUND

Gentlemen:

As National Distributor for the shares of Wellington Fund, Windsor Fund, Ivest Fund, Explorer Fund, W. L. Morgan Growth Fund, Trustees' Equity Fund, Wellesley Income Fund, and any other mutual fund for which we may hereafter act as Distributor (the "Funds"), we invite you to become a member of the Selling Group to distribute the shares of said Funds upon the following terms:

Ordering of Shares

1. Orders received from you will be accepted by us for the Funds only at the public offering price applicable to each order, as established in accordance with the provisions of the then current Prospectus of each of the Funds. The procedure stated herein relating to the pricing and handling of orders shall be subject to instructions which we will forward from time to time to all members of the Selling Group. All orders are subject to acceptance or rejection by the Funds in their sole discretion.

2. You agree to purchase shares only from the Funds through us or from your customers. If you purchase shares from the Funds you agree that all such purchases shall be made only to cover orders already received by you from your customers (who may be any persons other than a securities dealer or broker), or for your own investment. If you purchase shares from your customers, you agree to pay such customers not less than the bid prices quoted by us as agent at the time of such purchase. As distributor,

we will not accept a conditional offer for shares of the Funds.

3. You agree to sell shares only

(a) as principal, for your own account, to customers at the public offering price then in effect;

(b) to the Funds through Wellington Management Company, as agent for the Funds at the net asset value next determined after our receipt of the request for repurchase of the shares subject to such procedural standards as may from time to time be established or approved by the appropriate regulatory agencies. In such a sale to the Funds you may act either as principal for your own account or as agent for your customer. If you act as principal for your own account, you agree to pay your customer (unless the shares are in your investment account) not less than the price so determined. If you act as agent for your customer in selling shares to the Funds you may charge a fair commission for handling the transaction. All transactions in shares of Funds between you and us are between us as agent for the Funds concerned and you, either as principal for your own account or as agent for an undisclosed principal.

Dealer Discount and Sales Charge

4. The shares of the Funds will be offered to the public at a public offering price which will include a sales charge in varying amounts depending on the size of the purchase or other circumstances as described in the then current Prospectus of each of the Funds. On such sales you will receive a discount as shown in the following table (with the sales charge and discount stated as a percentage of the applicable offering price).

Amount of Sale	Gross Sales Charge	Dealer Discount
Less than $10,000 *	8.50%	7.00%
$10,000 but under $25,000	7.75	6.25
$25,000 but under $50,000	6.00	4.50
$50,000 but under $100,000	4.50	3.50

* The minimum initial purchase for Explorer Fund is $5,000.

Amount of Sale	Gross Sales Charge	Dealer Discount
$100,000 but under $250,000.....	3.25	2.50
$250,000 but under $500,000.....	2.50	2.00
$500,000 but under $1,000,000....	2.00	1.50
$1,000,000 but under $5,000,000..	1.50	1.125
$5,000,000 and over	1.00	0.75

5. The Funds may change the amount of the gross sales charge or the dealer discount or both at any time upon written notice to you.

6. You shall not withhold placing with us orders received from your customers so as to profit yourself as a result of such withholding, nor shall we accept from you any order for shares on any basis other than in accordance with the rules for such orders as may, from time to time, be established by the appropriate regulatory agencies.

7. If any shares sold to you under the terms of this agreement are repurchased by the Funds or by Wellington Management Company for the account of the Funds, or are tendered for repurchase or redemption within seven business days after the date of the confirmation of the original purchase by you, it is agreed that you shall forfeit your right to any discount received by you on such shares.

We shall notify you of any such repurchase or redemption within ten business days from the date on which the certificate is delivered to Wellington Management Company, or to the Funds and you shall forthwith refund to us the full discount allowed to you on such sale. We agree, in the event of any such repurchase or redemption, to refund to the Funds our share of the sales charge and upon receipt from you of the refund of the discount allowed to you, to pay such refund forthwith to the Funds.

8. Notwithstanding any of the foregoing provisions, orders to purchase shares received by us in connection with any exchange privilege made available to the shareholders of the respective Funds will be at the public offering price less all sales charges as applicable to each order and established by the then effective Prospectus of the Fund concerned. Orders to redeem shares under such exchange privilege shall not be subject to commission charge by either you or us.

Payment and Delivery

9. Orders and confirmation should be sent directly to Wellington Management Company, 1630 Locust Street, Philadelphia, Pa. 19103. Payment for shares shall be made payable to the order of Wellington Management Company and sent to the Funds' Transfer Agent, Data-Sys-Tance, Inc., P. O. Box 1400, Kansas City, Mo. 64141. The Funds reserve the right to delay issuance or transfer until the check is cleared. Payment shall be received by us within five days after acceptance by us for the Funds of your order. If such payment is not so received we reserve the right, without notice, forthwith to cancel the sale, and we may hold you responsible for any loss, including loss of profit, suffered by us or by the Funds resulting from your failure to make such payment.

10. No person is authorized to make any representations concerning shares of the Funds except those contained in the then current Prospectus of each of the Funds and in printed information subsequently issued by each of the Funds as information supplemental to such Prospectus. In all sales of these shares to the public you shall act as dealer for your own account, and in no transaction shall you have any authority to act as agent for the Funds for us or for any other member of the Selling Group. In purchasing shares from us you shall rely solely on the representations contained in the Prospectus of each of the Funds concerned and supplemental information above mentioned.

11. Additional copies of the then current Prospectus for each of the Funds and any printed information issued as supplemental to such Prospectus will be supplied by us in reasonable quantities upon request.

12. The Funds reserve the right in their own discretion, without notice, at any time and from time to time, to suspend sales or withdraw the offering of shares entirely. We reserve the right to amend this Agreement, and to reject in whole or in part any order received by us from you. Either party hereto may cancel this Agreement at any time. All purchase orders received by us will be subject to receipt of shares by us from the Fund concerned.

13. Each of us hereby represents and agrees that each of us is and will continue to be during the life of this Agreement a member of the National Association of Securities Dealers, Inc., or that we are a foreign dealer and we are

not eligible for membership in said Association, and in any event we both hereby agree to abide by the Rules of Fair Practice of that Association.

14. All communications to us should be sent to the above address. Any notice to you shall be duly given if mailed or telegraphed to you at the address specified by you below. This Agreement shall be construed in accordance with the laws of Pennsylvania.

15. Your first order placed with us for the purchase of shares of any of the Funds will represent your acceptance of this Agreement.

WELLINGTON MANAGEMENT COMPANY
By William G. Gallagher
Senior Vice President—Sales

Please return one signed copy of this agreement to:
Wellington Management Company
Order Department
1630 Locust Street
Philadelphia, Pa. 19103

Accepted:

Firm Name: ....
By: ....
Address: ....
....
Date: ....

(Title Omitted in Printing)

ANSWER OF:
BACHE & CO. INCORPORATED, et al.

Defendants Bache & Co. Incorporated; Dean Witter & Co. Incorporated; duPont Glore Forgan Incorporated; E. F. Hutton & Company Inc.; Hornblower & Weeks-Hemphill, Noyes Incorporated; Merrill Lynch, Pierce, Fenner & Smith Inc.; Paine, Webber, Jackson & Curtis Incorporated; Reynolds Securities Inc.; and Walston & Co. Inc. (hereinafter referred to for purposes of this answer as "defendant dealers") by their attorneys, Hogan & Hartson, answer the complaint in the above-captioned action as follows:

First Defense

1. Defendant dealers deny that this action is instituted to prevent or restrain violations of the law or to enforce the law and allege that, on the contrary, this action is instituted by the Department of Justice to change the law and is an effort by the Department of Justice to attain legislative objectives by means of litigation.

2. The acts and practices of defendant dealers in the distribution, sale, purchase, and redemption of redeemable investment company securities are, have been, and were intended to be honest, open, and public efforts to comply with the letter and spirit of the laws of the United States, including the statute which makes it a federal criminal offense for such dealers to sell any such securities to any person except a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus. Defendant dealers have operated in accordance with their understanding that those laws and that statute do not permit evasion or avoidance by any sham, artifice, or convenient choice of words to describe the capacity in which they deal in redeemable investment company securities. Defendants allege and aver that their understanding is and has been the general understanding of the securities industry and its related legal community, as promoted, shared, and acquiesced in for more than three decades by the United States Congress and the Securities and Exchange Commission, among others.

3. Since each of the defendant dealers has individually and in good faith sought to obey the letter and spirit of the

law with respect to the acts and practices referred to in the complaint, even if the Court should interpret the law differently than the defendant dealers, the securities industry, the government, and the public have been interpreting the law for more than 30 years since enactment of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*, the course of conduct and acts of the defendant dealers referred to in the complaint do not indicate any intent or tendency to disregard the law. On the contrary, the course of conduct and acts of defendant dealers demonstrate a scrupulous regard for the law and an effort to comply fully with its letter and spirit. Accordingly, there is no basis, ground, or warrant for the entry of any injunction or order against the defendant dealers or for the granting of any relief herein against the defendant dealers.

Second Defense

(As to Jurisdiction and Venue)

4. In answer to paragraph 1 of the complaint, defendant dealers deny each and every allegation therein, except that they admit that the Act of Congress of July 2, 1890, 15 U.S.C. §§ 1 *et seq.*, as amended, is commonly known as the Sherman Act.

5. In answer to paragraph 2 of the complaint, defendant dealers admit that each defendant dealer transacts business or is found within the District of Columbia. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny that each of the other defendants named in each of the counts of the complaint does or does not transact business within the District of Columbia or is or is not found within the District of Columbia.

(As to Definitions)

6. In answer to paragraph 3(a) of the complaint, defendant dealers admit that the term "investment company" is defined in section 3 of the Investment Company Act of 1940, 15 U.S.C. § 80a-3, that the term "management company" is defined in section 4(3) of that Act, 15 U.S.C. § 80a-4(3), and that the term "open-end company" is defined in section 5(a)(1) of that Act, 15 U.S.C. § 80a-5(a)(1). Defendant dealers deny that the term "mutual fund" is defined in the Investment Company Act of 1940. They further deny that it is either statutorily correct, proper,

or helpful to define a "mutual fund" as meaning "an open-end management investment company." They admit that plaintiff has attempted to construct and use such a definition in the complaint.

7. In answer to paragraph 3(b) of the complaint, defendant dealers admit that the term "principal underwriter" is defined in section 2(a)(29) of the Investment Company Act of 1940, 15 U.S.C. § 80a-2(a)(29), but deny that that definition employs the term "mutual fund." They admit that plaintiff has attempted to construct and use such a definition in the complaint.

8. In answer to paragraph 3(c) of the complaint, defendant dealers deny that the term "broker/dealer" is defined in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*, the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.*, the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*, or any of the other securities statutes of the United States. Defendant dealers admit that plaintiff has attempted to construct and use such a definition in the complaint. Defendant dealers admit that each is registered with the Securities and Exchange Commission as required by section 15 of the Securities Exchange Act of 1934, 15 U.S.C. § 78o.

9. In answer to paragraphs 3(d) and 3(e) of the complaint, defendant dealers deny that the terms "brokerage transaction" and "dealer transaction" are defined or used in the Investment Company Act of 1940. Defendant dealers admit that plaintiff has attempted to construct definitions of such terms in the complaint. Defendant dealers allege and aver that the use and juxtaposition of these terms in the complaint is misleading, confusing, and contrary to the intent of Congress as expressed in 1940 when Congress passed the Investment Company Act.

10. In answer to paragraphs 3(f)(g) and (h) of the complaint, defendant dealers deny that the terms "primary distribution system," "secondary dealer market," and "brokerage market" are defined or used in the Investment Company Act of 1940. Defendant dealers admit that plaintiff has attempted to construct and use such definitions in the complaint. Defendant dealers allege and aver that the use and juxtaposition of such terms in the complaint is misleading, confusing, and contrary to the intent of Congress as expressed in 1940 when Congress passed the Investment Company Act.

(As to Count I)

11. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny the allegations of paragraphs 4, 5, and 6 of the complaint, except that they admit that The Crosby Corporation is the principal underwriter of certain "Fidelity" funds, Vance, Sanders & Company is the principal underwriter of certain "Vance, Sanders" funds, and the Wellington Management Company is the principal underwriter of certain "Wellington" funds.

12. Subject to its answer made in response to paragraph 3 of the complaint, which answer is incorporated herein by reference, each defendant dealer admits, as to itself, that it is a corporation and has a principal office in the city indicated by paragraph 7 of the complaint, and avers, upon information and belief, that the allegations of that paragraph are true as to each other defendant dealer. Each defendant dealer avers, however, that its corporate name is as appears in the preamble paragraph on the first page of this answer. To the extent that the dealer names alleged in plaintiff's complaint are inconsistent with the names used in this answer, defendant dealers deny that the names alleged in the complaint are correct.

13. Defendant dealers admit the allegations of paragraph 8 of the complaint subject to their answer made in response to paragraph 3 of the complaint, which answer is incorporated herein by reference.

14. Defendant dealers admit the allegations of paragraph 9 of the complaint subject to their answer made in response to paragraph 3 of the complaint, which answer is incorporated herein by reference.

15. Defendant dealers lack knowledge or information sufficient to enable them to affirm or deny the allegations of paragraph 10 of the complaint.

16. Defendant dealers admit the allegations of paragraph 11 of the complaint subject to their answer made in response to paragraph 3 of the complaint, which answer is incorporated herein by reference.

17. Defendant dealers admit the allegation in the first sentence of paragraph 12 of the complaint subject to their answer made in response to paragraph 3 of the complaint, which answer is incorporated herein by reference. Defendant dealers are without knowledge or information sufficient

to enable them to affirm or deny the remaining allegations in paragraph 12 of the complaint.

18. In answer to paragraph 13 of the complaint, defendant dealers deny that Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(d), uses the terms "broker/dealer," "dealer transaction," or "mutual fund." Any characterization of that section to the contrary is completely misleading and totally unfounded. Section 22(d) reads, in full, as follows:

> (d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 including any offer made pursuant to section 11(b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

19. In answer to paragraph 14 of the complaint, defendant dealers deny that the securities laws in general, or the Investment Company Act of 1940 in particular, define and use the terms "brokerage transaction" and "dealer transaction." Defendant dealers further deny that section 22(d) of the Investment Company Act uses the term "broker/dealer." Any characterization of that section to the contrary is completely misleading and totally unfounded. Defendant dealers deny each and every other allegation in paragraph 14 of the complaint.

20. Defendant dealers deny each and every allegation in paragraphs 15 and 16 of the complaint.

21. Defendant dealers admit that defendant NASD has issued rules and regulations governing the activities of its membership, which rules were duly promulgated pursuant to authority granted by Congress in the various federal securities statutes and approved, acknowledged, and acquiesced in by the Securities and Exchange Commission. Defendant dealers deny each and every other allegation in paragraphs 17 and 18 of the complaint.

(As to Count II)

22. The allegations in paragraphs 19 and 20 of the complaint are formal allegations to which no answer is necessary.

23. In answer to paragraph 21 of the complaint, defendant dealers reallege in full their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

24. In answer to paragraph 22 of the complaint, each defendant dealer admits that it has signed a standard form dealer agreement furnished to it by defendant The Crosby Corporation. Attached hereto as "Exhibit A" is a specimen of such standard form agreement. Upon information and belief, each defendant dealer alleges and avers that each other defendant dealer has signed such a standard form agreement, as have non-defendant dealers. Defendant dealers deny that such agreements are in unreasonable restraint of trade and commerce, deny that such agreements are in violation of the antitrust laws, and deny each and every other allegation of paragraph 22 of the complaint.

25. In answer to paragraph 23 of the complaint, each defendant dealer alleges and avers that the terms of the standard form agreement furnished to it by The Crosby Corporation are set forth in that agreement. Defendant dealers deny each and every other allegation of paragraph 23 of the complaint.

26. Defendant dealers deny each and every allegation of paragraph 24 of the complaint.

(As to Count III)

27. Many of the allegations of paragraphs 25 and 26 are formal allegations to which no answer is required. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny any non-formal allegations of paragraphs 25 and 26 of the complaint.

28. In answer to paragraph 27 of the complaint, defendant dealers reallege in full their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

29. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny the allegations of paragraphs 28 through 30 of the complaint.

(As to Count IV)

30. The allegations of paragraphs 31 and 32 of the complaint are formal allegations to which no answer is required.

31. In answer to paragraph 33 of the complaint, defendant dealers reallege in full their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

32. In answer to paragraph 34 of the complaint, each defendant dealer admits that it has signed a standard form dealer agreement furnished to it by defendant Vance, Sanders and Company, Inc. Attached hereto as "Exhibit B" is a specimen of such standard form agreement. Upon information and belief, each defendant dealer alleges and avers that each other defendant dealer has signed such a standard form agreement, as have non-defendant dealers. Defendant dealers deny that such agreements are in unreasonable restraint of trade and commerce, deny that such agreements are in violation of the antitrust laws, and deny each and every other allegation of paragraph 34 of the complaint.

33. In answer to paragraph 35 of the complaint, each defendant dealer alleges and avers that the terms of the standard form agreement furnished to it by Vance, Sanders and Company, Inc., are set forth in such agreement. Defendant dealers deny each and every other allegation of paragraph 35 of the complaint.

34. Defendant dealers deny each and every allegation of paragraph 36 of the complaint.

(As to Count V)

35. Many of the allegations of paragraph 37 of the complaint are formal allegations to which no answer is required. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny the non-formal allegations of paragraph 37 of the complaint.

36. The allegations of paragraph 38 of the complaint are formal allegations to which no answer is required.

37. In answer to paragraph 39 of the complaint, defendant dealers reallege in full their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

38. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny the allegations of paragraphs 40 through 42 of the complaint.

(As to Count VI)

39. The allegations of paragraphs 43 and 44 of the complaint are formal allegations to which no answer is required.

40. In answer to paragraph 45 of the complaint, defendant dealers reallege in full their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

41. In answer to paragraph 46 of the complaint, each defendant dealer admits that it has signed a standard form dealer agreement furnished to it by defendant Wellington Management Company. Attached hereto as "Exhibit C" is a specimen of such standard form agreement. Upon information and belief, each defendant dealer alleges and avers that each other defendant dealer has signed such a standard form agreement, as have non-defendant dealers. Defendant dealers deny that such agreements are in unreasonable restraint of trade and commerce, deny that such agreements are in violation of the antitrust laws, and deny each and every other allegation of paragraph 46 of the complaint.

42. In answer to paragraph 47 of the complaint, each defendant dealer alleges and avers that the terms of the standard form agreement furnished to it by The Crosby Corporation are set forth in such agreement. Defendant dealers deny each and every other allegation of paragraph 47 of the complaint.

43. Defendant dealers deny each and every allegation of paragraph 48 of the complaint.

(As to Count VII)

44. Many of the allegations in paragraph 49 and all of the allegations in paragraph 50 of the complaint are formal allegations to which no answer is required. Defendant dealers are without knowledge or information sufficient to enable

them to affirm or deny the non-formal allegations of paragraph 49 of the complaint.

45. In answer to paragraph 51 of the complaint, defendant dealers reallege in full their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

46. Defendant dealers are without knowledge or information sufficient to enable them to affirm or deny the allegations of paragraphs 52 through 54 of the complaint.

(As to Count VIII)

47. The allegations in paragraph 55 of the complaint are formal allegations to which no response is required.

48. In answer to paragraph 56 of the complaint, defendant dealers reallege their answers to paragraphs 9 through 14 of the complaint and incorporate those answers herein by reference.

49. In answer to paragraph 57 of the complaint, each defendant dealer admits that from time to time it has signed standard form dealer agreements furnished to it by principal underwriters other than defendant principal underwriters. Defendant dealers deny that such agreements are in unreasonable restraint of trade and commerce, deny that such agreements are in violation of the antitrust laws, and deny each and every other allegation in paragraph 57 of the complaint.

50. In answer to paragraph 58 of the complaint, defendant dealers allege and aver that the terms of such agreements are set forth in the standard form agreements themselves. A specimen of the standard form agreement used by each principal underwriter is on public file with the Securities & Exchange Commission in Washington, D.C., and is available there for plaintiff's inspection. Defendant dealers deny each and every other allegation of paragraph 58 of the complaint.

51. Defendant dealers deny each and every allegation of paragraph 59 of the complaint.

(As to all Counts)

Third Defense

52. The complaint fails to state a claim against any of defendant dealers upon which relief can be granted.

Fourth Defense

53. The court lacks jurisdiction over the subject matter of the claims alleged in this action.

Fifth Defense

54. All acts and practices of each of said defendant dealers in the distribution, sale, purchase, and redemption of redeemable investment company securities are and have been authorized by, mandated by, and done in full conformity with the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*, and the other federal securities statutes, and accordingly, such acts and practices of said defendants are exempt and immune from any claim for violation of the federal antitrust laws.

Sixth Defense

55. All acts and practices of each of said defendant dealers in the distribution, sale, purchase, and redemption of redeemable investment company securities are and have been authorized by, mandated by, and done in full conformity with the rules, regulations, orders, and other communications issued by the Securities and Exchange Commission, which Commission, as duly authorized by Congress, has engaged in continuous and pervasive surveillance, supervision, regulation, and control of such acts and practices, and accordingly, such acts and practices of said defendants are exempt and immune from any claim for violation of the federal antitrust laws.

Seventh Defense

56. All acts and practices of each of said defendant dealers in the distribution, sale, purchase, and redemption of redeemable investment company securities are and have been authorized by, mandated by, and done in full conformity with the rules, regulations, orders, and other communications issued by the National Association of Securities Dealers, which Association, as duly authorized by Congress and kept under continuous and pervasive surveillance, supervision, regulation, and control by the Securities and Exchange Commission, has engaged in continuous and pervasive surveillance, supervision, regulation, and control of such acts and practices, and accordingly, such acts and prac-

tices of said defendants are exempt and immune from any claim for violation of the federal antitrust laws.

Eighth Defense

57. By reason of the authority vested in it under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*, as amended, the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*, as amended, and the other federal securities statutes, the Securities and Exchange Commission has exclusive jurisdiction to regulate those acts and practices which are the subject of the purported claims in this action.

Ninth Defense

58. Plaintiff has not exhausted its remedies, nor alleged any effort on its part, to obtain redress from the Securities and Exchange Commission for the claims alleged in the complaint or to obtain any regulation, ruling, order, or other action by the Securities and Exchange Commission with regard to the subjects raised in the complaint, and accordingly, the action should be dismissed.

Tenth Defense

59. By reason of the authority vested in it under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*, as amended, the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*, as amended, and the other federal securities statutes, the Securities and Exchange Commission has primary jurisdiction to regulate those acts and practices which are the subject of the purported claims in the complaint, and accordingly, this action should be dismissed or, at least, the Court should refuse to consider or otherwise proceed in this action until such time as the plaintiff has first obtained a hearing and an administrative decision by the Securities and Exchange Commission with regard to the subjects raised in the complaint.

Eleventh Defense

60. The Securities and Exchange Commission is presently conducting hearings and may subsequently attempt to make findings on some of the matters referred to in the complaint, and accordingly, this action is not ripe for judicial intervention or decision and should be dismissed.

WHEREFORE, each of said defendant dealers prays for

judgment dismissing the complaint herein, together with its costs, disbursements, and attorneys' fees.

HOGAN & HARTSON

By ______________________
Lee Loevinger

____
Owen M. Johnson, Jr.

____
David J. Saylor

HOGAN & HARTSON
815 Connecticut Avenue, N. W.
Washington, D. C. 20006
202-298-5500

Attorneys for defendants,
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Dean Witter & Co. Incorporated
duPont Glore Forgan Incorporated
E. F. Hutton & Company Inc.
Hornblower & Weeks-Hemphill, Noyes Incorporated
Merrill Lynch, Pierce, Fenner & Smith Inc.
Paine, Webber, Jackson & Curtis Incorporated
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New York, New York 10022

of counsel for defendant
duPont Glore Forgan Incorporated

DATED: March 26, 1973

EXHIBIT A

SALES AGREEMENT

The Crosby Corporation,
Distributor
225 Franklin Street,
Boston, Mass. 02110
Executive Offices—
617-726-0400—Cable-
Crosfidel
Order Department—
617-742-5700—Teletype
710-321-0411

Fidelity Fund, Inc.
Fidelity Bond Debenture Fund, Inc.
Fidelity Capital Fund, Inc.
Fidelity Trend Fund, Inc.
Puritan Fund, Inc.
Salem Fund, Inc.
Everest Fund, Inc.

The Fidelity Group of Mutual Funds

November 1, 1972

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price computed as described in the applicable Fund's then currently effective Prospectus, less the Dealer Discount described below. The net asset value and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as folows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Sales Charge Paid by Investor	Dealer Discount
On investments of	*	$ 10,000	8.5%	7.0%
On investments of	$ 10,000	25,000	8.0%	6.5%
On investments of	25,000	50,000	6.0%	4.8%
On investments of	50,000	100,000	4.5%	3.6%
On investments of	100,000	250,000	3.5%	2.8%
On investments of	250,000	500,000	2.5%	2.0%
On investments of	500,000	1,000,000	2.0%	1.6%
On investments over	1,000,000		1.0%	0.8%

* The minimum initial and subsequent investments must be as specified in the then currently effective applicable Fund Prospectus.

The schedule of sales charges and dealer discounts set forth above is applicable to purchases by "any person" (a) of a single Fund at any one time, or (b) in accordance with "Combined Purchase Privilege," "Cumulative Quantity Discount" and/or "Statement of Intention" as each of those terms is described in the then currently effective applicable Fund Prospectus. You must notify us of the total holdings, if applicable, of "any person" before he may avail himself of a reduced sales charge pursuant to the foregoing. Such notification, in writing, must be received by Crosby within four (4) business days of the placing of the order. An application form is available for this purpose. As used in this paragraph, "any person" means an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other like fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and

holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the applicable Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made as follows:

The Crosby Corporation
Cash Clearing Department, 3rd Floor
Ten Post Office Square
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100. WE RESERVE THE RIGHT TO HOLD YOU RESPONSIBLE FOR ANY LOSS WE MAY INCUR AS THE RESULT OF YOUR FAILURE TO MAKE ANY SUCH PAYMENTS.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the net asset value then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in

the then currently effective applicable Fund Prospectus), unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling to us for the account of an investor any shares of the appropriate Fund at the net asset value price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the dealer discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, as amended, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the then currently effective applicable Fund Prospectus and in such other printed information as may be subsequently issued by us as information supplemental to such Prospectus or approved by us in writing for use in connection therewith. You will

not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Salem Fund, Inc.," "Everest Fund, Inc.," "Fidelity Bond-Debenture Fund, Inc.," "Fidelity Group of Funds" or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent or representative of any of the Funds or of this Corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

This Agreement supersedes and cancels any prior agreement with respect to the sale of shares of any of the Funds for which we are the principal underwriter and we reserve the right to amend this Agreement at any time and from time to time or to terminate the same at any time.

We and/or the Funds in the Fidelity Group of Funds may at any time modify the sales charge and dealer discount to be paid in connection with the sale of shares of any of those Funds. In the event of any such change you agree that you will have no continuing claim to or vested interest in the level of sales charges or dealer discounts established by this Agreement as to any shares purchased subsequent to such change.

Very truly yours,
THE CROSBY CORPORATION
By ....

The undersigned hereby accepts this Agreement and agrees to abide by all of its terms and conditions.

Dated as of November 1, 1972

Firm ....
By ....
Authorized Signature
Address ....

EXHIBIT B

VANCE, SANDERS & COMPANY, INC.
111 Devonshire Street
Boston 02109

Boston Fund
Boston Common Stock Fund
Century Shares Trust
Massachusetts Capital Development Fund
Massachusetts Financial Development Fund
Massachusetts Income Development Fund
Massachusetts Investors Growth Stock Fund
Massachusetts Investors Trust
Vance, Sanders Special Fund

Dear Sirs:

We are the Principal Underwriter of the shares of Boston Fund, Inc., Boston Common Stock Fund, Inc., Century Shares Trust, Massachusetts Capital Development Fund, Inc., Massachusetts Financial Development Fund, Inc., Massachusetts Income Development Fund, Inc., Massachusetts Investors Growth Stock Fund, Inc., Massachusetts Investors Trust and Vance, Sanders Special Fund, Inc. and, as such, have the exclusive right to distribute shares of these Funds for resale. As principal, we offer to sell to you, as a member of the Selling Group, shares of each of these Funds upon the following terms and conditions:

1. In all sales of these shares to the public you shall act as dealer for your own account, and in no transaction shall you have any authority to act as agent for the issuer, for us or for any other member of the Selling Group.

2. Orders received from you will be accepted through us only at the public offering price applicable to each order, as established by the then current Prospectus of the Fund for whose shares the order is placed. The procedure relating to the handling of orders shall be subject to instructions which we shall forward from time to time to all members of the Selling Group. All orders are subject to acceptance or rejection by us in our sole discretion.

3. For a schedule of the offering prices of the shares of each of the Funds and of your discount with respect to the sale of shares of each of the Funds see the reverse side

hereof. The term "single transaction" shall have the same meaning as set forth in the current Prospectus of each Fund.

4. You agree to purchase shares only through us or from your customers other than dealers or brokers. If you purchase shares through us, you agree that all such purchases shall be made only to cover orders already received by you from your customers, or for your own bona fide investment. If you purchase shares from your customers, you agree to pay such customers not less than the bid price quoted by us as agent for the issuer at the time of such purchase.

5. You shall sell shares only

(a) to customers at the public offering price then in effect.

(b) to us or the Fund upon the terms and conditions set forth in the current Prospectus of each Fund. In such a sale, you may act either as principal for your own account or as agent for your customer. If you act as agent for your customer in selling shares, you agree not to charge your customer more than a fair commission for handling the transaction.

6. You shall not withhold placing through us orders received from your customers so as to profit yourself as a result of such withholding: e.g., by a change in the "net asset value" from that used in determining the offering price to your customers.

7. We will not accept from you any conditional orders or shares, except at a definite specified price.

8. If any shares sold to you under the terms of this agreement are repurchased by the issuer or by us as agent for any such Fund or are tendered for redemption, within seven business days after the date of our confirmation of the original purchase by you, it is agreed that you shall forfeit your right to any discount received by you on such shares.

We will notify you of any such repurchase or redemption within ten business days from the date on which the certificate is delivered to us or to the issuer, and you shall forthwith refund to us the full discount allowed to you, and we agree to pay such refund forthwith to the issuer.

9. Payment for shares ordered from us shall be in New York or Boston clearing house funds received by us within five days after our acceptance of your order. If such pay-

ment is not received by us, we reserve the right, without notice, forthwith to cancel the sale, or, at our option, to sell the shares ordered back to the issuer, in which latter case we may hold you responsible for any loss, including loss of profit, suffered by us resulting from your failure to make payment as aforesaid.

10. Shares sold to you hereunder shall be available to you for delivery against payment at the office of our agent, the New England Merchants National Bank, Mutual Funds Clearance Department, Boston, Massachusetts, unless other arrangements are made with us for delivery and payment.

11. No person is authorized to make any representations concerning shares of the issuer except those contained in the current Prospectus and in such printed information subsequently issued by us as information supplemental to such Prospectus. In purchasing shares through us you shall rely solely on the representations contained in the appropriate Prospectus and supplemental information above mentioned. Qualification of the shares of Boston Fund, Inc., Boston Common Stock Fund, Inc., Century Shares Trust, Massachusetts Capital Development Fund, Inc., Massachusetts Financial Development Fund, Inc., Massachusetts Income Development Fund, Inc., Massachusetts Investors Growth Stock Fund, Inc., Massachusetts Investors Trust and Vance, Sanders Special Fund, Inc. in the various states, including the filing of any state or further state notices respecting such shares, and any printed information which we furnish you other than the Funds' Prospectuses and periodic reports are our sole responsibility and not the responsibility of the respective Funds, and you agree that these Funds shall have no liability or responsibility to you in these respects.

12. Additional copies of any current Prospectus and any printed information issued as supplemental to such Prospectus will be supplied by us in reasonable quantities upon request.

13. We reserve the right in our discretion, without notice, to suspend sales or withdraw the offering of shares entirely. Each party hereto has the right to cancel this agreement upon notice to the other party.

14. You represent that you are a member of the National Association of Securities Dealers and we both hereby agree to abide by the Rules of Fair Practice of such Association.

15. All communications to us should be sent to the above

address. Any notice to you shall be duly given if mailed or telegraphed to you at the address specified by you below. This agreement shall be construed in accordance with the laws of Massachusetts.

16. This agreement supersedes and cancels any prior agreement with respect to the sale of shares of any of the aforementioned Funds.

17. You appoint the transfer agent for each Fund as your agent to execute the purchase transactions of shares of each Fund in accordance with the terms and provisions of any account, program, plan or service established or used by your customers and to confirm each purchase to your customers on your behalf, and you guarantee the legal capacity of your customers so purchasing such shares and any co-owners of such shares.

NOTE: The term "net asset value" as used in paragraphs 5 and 6 and on the schedule "Offering Prices" means "liquidating value" in the case of Boston Fund and Century Shares Trust.

VANCE, SANDERS & COMPANY, INC.
By John D. Wilson
President

Dated May 1, 1972

The undersigned hereby accepts the offer set forth in the above letter.

Firm ....
By ....
Authorized Representative
Address ....

Offering Prices

In single transactions by you of shares of Boston Fund, Boston Common Stock Fund, Century Shares Trust, Massachusetts Capital Development Fund, Massachusetts Financial Development Fund, Massachusetts Income Development Fund, Massachusetts Investors Growth Stock Fund, Massachusetts Investors Trust or Vance, Sanders Special Fund involving: (1) less than $12,500, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .915, in each case determined in the manner and as of the time specified in the Prospectus; (2) $12,500 but less than $25,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .925; (3) $25,000 but less than $50,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9125; (4) $50,000 but less than $100,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .96; (5) $100,000 but less than $250,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9675; (6) $250,000 but less than $500,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .975; (7) $500,000 but less than $1,000,000, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9775; and (8) $1,000,000 or more, the public offering price of each of these Funds will be fixed by dividing the "net asset value" per share by .9825.

Dealer Discounts

On the purchase of shares by you to cover a single transaction involving: (1) less than $12,500, you shall receive a discount from the applicable public offering price of 6.50% with respect to shares of Boston Fund, Boston Common Stock Fund, Century Shares Trust, Massachusetts Capital Development Fund, Massachusetts Financial Development Fund, Massachusetts Income Development Fund, Massachusetts Investors Growth Stock Fund, Massachusetts Investors Trust and Vance, Sanders Special Fund, except that in supplementary purchases of shares of any of these

Funds under the invest-by-mail program, you shall receive a discount from the applicable public offering price of 6.00% (except that on Dividend Reinvestments only, discounts of less than $5 will not be paid); (2) $12,500 but less than $25,000, you shall receive a discount from the applicable public offering price of 6.00%; (3) $25,000 but less than $50,000, you shall receive a discount from the applicable public offering price of 4.25%; (4) $50,000 but less than $100,000, you shall receive a discount from the applicable public offering price of 3.00%; (5) $100,000 but less than $250,000, you shall receive a discount from the applicable public offering price of 2.50%; (6) $250,000 but less than $500,000, you shall receive a discount from the applicable public offering price of 2.00%; (7) $500,000 but less than $1,000,000, you shall receive a discount from the applicable public offering price of 1.75% and (8) $1,000,000 or more, you shall receive a discount from the applicable public offering price of 1.25%.

EXHIBIT C

WELLINGTON MANAGEMENT COMPANY
1630 LOCUST STREET • PHILADELPHIA, PA. 19103

Sales Agreement

with respect to

WELLINGTON FUND WINDSOR FUND IVEST FUND W. L. MORGAN GROWTH FUND WELLESLEY INCOME FUND EXPLORER FUND TRUSTEES' EQUITY FUND

Gentlemen:

As National Distributor for the shares of Wellington Fund, Windsor Fund, Ivest Fund, Explorer Fund, W. L. Morgan Growth Fund, Trustees' Equity Fund, Wellesley Income Fund, and any other mutual fund for which we may hereafter act as Distributor (the "Funds"), we invite you to become a member of the Selling Group to distribute the shares of said Funds upon the following terms:

Ordering of Shares

1. Orders received from you will be accepted by us for the Funds only at the public offering price applicable to each order, as established in accordance with the provisions of the then current Prospectus of each of the Funds. The procedure stated herein relating to the pricing and handling of orders shall be subject to instructions which we will forward from time to time to all members of the Selling Group. All orders are subject to acceptance or rejection by the Funds in their sole discretion.

2. You agree to purchase shares only from the Funds through us or from your customers. If you purchase shares from the Funds you agree that all such purchases shall be made only to cover orders already received by you from your customers (who may be any persons other than a securities dealer or broker), or for your own investment. If you purchase shares from your customers, you agree to pay such customers not less than the bid prices quoted by us as agent at the time of such purchase. As distributor, we will not accept a conditional offer for shares of the Funds.

3. You agree to sell shares only

(a) as principal, for your own account, to customers at the public offering price then in effect;

(b) to the Funds through Wellington Management Company, as agent for the Funds at the net asset value next determined after our receipt of the request for repurchase of the shares subject to such procedural standards as may from time to time be established or approved by the appropriate regulatory agencies. In such a sale to the Funds you may act either as principal for your own account or as agent for your customer. If you act as principal for your own account, you agree to pay your customer (unless the shares are in your investment account) not less than the price so determined. If you act as agent for your customer in selling shares to the Funds you may charge a fair commission for handling the transaction. All transactions in shares of Funds between you and us are between us as agent for the Funds concerned and you, either as principal for your own account or as agent for an undisclosed principal.

Dealer Discount and Sales Charge

4. The shares of the Funds will be offered to the public at a public offering price which will include a sales charge in varying amounts depending on the size of the purchase or other circumstances as described in the then current Prospectus of each of the Funds. On such sales you will receive a discount as shown in the following table (with the sales charge and discount stated as a percentage of the applicable offering price).

Amount of Sale	Gross Sales Charge	Dealer Discount
Less than $10,000 *	8.50%	7.00%
$10,000 but under $25,000	7.75	6.25
$25,000 but under $50,000	6.00	4.50
$50,000 but under $100,000	4.50	3.50
$100,000 but under $250,000	3.25	2.50
$250,000 but under $500,000	2.50	2.00
$500,000 but under $1,000,000	2.00	1.50
$1,000,000 but under $5,000,000	1.50	1.125
$5,000,000 and over	1.00	0.75

* The minimum initial purchase for Explorer Fund is $5,000.

5. The Funds may change the amount of the gross sales charge or the dealer discount or both at any time upon written notice to you.

6. You shall not withhold placing with us orders received from your customers so as to profit yourself as a result of such withholding, nor shall we accept from you any order for shares on any basis other than in accordance with the rules for such orders as may, from time to time, be established by the appropriate regulatory agencies.

7. If any shares sold to you under the terms of this agreement are repurchased by the Funds or by Wellington Management Company for the account of the Funds, or are tendered for repurchase or redemption within seven business days after the date of the confirmation of the original purchase by you, it is agreed that you shall forfeit your right to any discount received by you on such shares.

We shall notify you of any such repurchase or redemption within ten business days from the date on which the certificate is delivered to Wellington Management Company, or to the Funds and you shall forthwith refund to us the full discount allowed to you on such sale. We agree, in the event of any such repurchase or redemption, to refund to the Funds our share of the sales charge and upon receipt from you of the refund of the discount allowed to you, to pay such refund forthwith to the Funds.

8. Notwithstanding any of the foregoing provisions, orders to purchase shares received by us in connection with any exchange privilege made available to the shareholders of the respective Funds will be at the public offering price less all sales charges as applicable to each order and established by the then effective Prospectus of the Fund concerned. Orders to redeem shares under such exchange privilege shall not be subject to commission charge by either you or us.

Payment and Delivery

9. Orders and confirmation should be sent directly to Wellington Management Company, 1630 Locust Street, Philadelphia, Pa. 19103. Payment for shares shall be made payable to the order of Wellington Management Company and sent to the Funds' Transfer Agent, Data-Sys-Tance, Inc., P. O. Box 1400, Kansas City, Mo. 64141. The Funds reserve the right to delay issuance or transfer until the check is cleared. Payment shall be received by us within

five days after acceptance by us for the Funds of your order. If such payment is not so received we reserve the right, without notice, forthwith to cancel the sale, and we may hold you responsible for any loss, including loss of profit, suffered by us or by the Funds resulting from your failure to make such payment.

10. No person is authorized to make any representations concerning shares of the Funds except those contained in the then current Prospectus of each of the Funds and in printed information subsequently issued by each of the Funds as information supplemental to such Prospectus. In all sales of these shares to the public you shall act as dealer for your own account, and in no transaction shall you have any authority to act as agent for the Funds for us or for any other member of the Selling Group. In purchasing shares from us you shall rely solely on the representations contained in the Prospectus of each of the Funds concerned and supplemental information above mentioned.

11. Additional copies of the then current Prospectus for each of the Funds and any printed information issued as supplemental to such Prospectus will be supplied by us in reasonable quantities upon request.

12. The Funds reserve the right in their own discretion, without notice, at any time and from time to time, to suspend sales or withdraw the offering of shares entirely. We reserve the right to amend this Agreement, and to reject in whole or in part any order received by us from you. Either party hereto may cancel this Agreement at any time. All purchase orders received by us will be subject to receipt of shares by us from the Fund concerned.

13. Each of us hereby represents and agrees that each of us is and will continue to be during the life of this Agreement a member of the National Association of Securities Dealers, Inc., or that we are a foreign dealer and we are not eligible for membership in said Association, and in any event we both hereby agree to abide by the Rules of Fair Practice of that Association.

14. All communications to us should be sent to the above address. Any notice to you shall be duly given if mailed or telegraphed to you at the address specified by you below. This Agreement shall be construed in accordance with the laws of Pennsylvania.

15. Your first order placed with us for the purchase of

shares of any of the Funds will represent your acceptance of this Agreement.

WELLINGTON MANAGEMENT COMPANY
By William G. Gallagher
Senior Vice President—Sales

Please return one signed copy of this agreement to:
Wellington Management Company
Order Department
1630 Locust Street
Philadelphia, Pa. 19103

Accepted:

Firm Name: ....

By: ....

Address: ....

....

Date: ....

(Certificate of service omitted in printing)

(Title Omitted in Printing)

MOTION TO DISMISS

Defendant National Association of Securities Dealers, Inc., pursuant to Rule 12 of the Federal Rules of Civil Procedure, moves this Court to dismiss the Complaints herein for failure to state a claim upon which relief can be granted and because this Court lacks jurisdiction over the subject matter. The Securities Exchange Act of 1934 and the Investment Company Act of 1940 provide immunity from the antitrust laws and confer exclusive jurisdiction upon the Securities and Exchange Commission, as more fully discussed in a memorandum submitted herewith. If the Court is unable to grant the motion to dismiss, the matters should be referred to the Securities and Exchange Commission pursuant to its primary jurisdiction.

Respectfully submitted,

/s/ Joseph B. Levin
JOSEPH B. LEVIN
Lund Levin & O'Brien
1625 I Street, N.W.
Washington, D C 20006
202-347-4377

/s/ Lloyd J. Derrickson
LLOYD J. DERRICKSON
General Counsel

/s/ Dennis C. Hensley
DENNIS C. HENSLEY
Assistant General Counsel
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D. C.
202-833-7200

Attorneys for Defendant National Association of Securities Dealers, Inc.

29 May 1973

(Title Omitted in Printing)

SIRS:

PLEASE TAKE NOTICE that, upon the annexed affidavits of John Barnard, Jr. and Thomas Otis, the annexed statement pursuant to General Rule 9(h) and the pleadings and prior proceedings herein, the undersigned hereby move for an order, pursuant to Rules 12(b)(6) and/or 56(b) of the Federal Rules of Civil Procedure, dismissing the complaint herein as to Massachusetts Investors Growth Stock Fund, Inc. ("MIGS") on the grounds that the only "violation" alleged against MIGS by the complaint herein is patently untrue and unsupportable on its face and that the practices and transactions complained of against the several defendants are exempted from the antitrust laws, and for such further relief as to the Court may seem just and proper.

Yours, etc.
SULLIVAN & CROMWELL

By ____________________
(A Member of the Firm)

48 Wall Street
New York, New York 10005
(212) HA 2-8100

and

WILLIAMS, CONNOLLY & CALIFANO

By ______________________________

1000 Hill Building
839 Seventeenth Street, N.W.
Washington, D.C. 20006
(202) 638-6565

Attorneys for defendant
Massachusetts Investors Growth
Stock Fund, Inc.

(Certificate of Service Omitted in Printing)

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, PLAINTIFF, —against— THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., et al., DEFENDANTS.	Civ. Action No. 338-73 AFFIDAVIT OF JOHN BARNARD, JR.

COMMONWEALTH OF MASSACHUSETTS
COUNTY OF SUFFOLK } ss.:

JOHN BARNARD, JR., being duly sworn, deposes and says:

1. I am an attorney and am a Vice President and Director of Massachusetts Investors Growth Stock Fund, Inc. ("MIGS").

2. MIGS' principal underwriter is Vance, Sanders & Company, Inc. ("Vance, Sanders"). A copy of the distribution agreement between MIGS and Vance, Sanders is annexed hereto as Exhibit A. This agreement, together with a letter of instructions with respect to redemptions (Exhibit B) and an exchange agreement among Vance, Sanders, MIGS and four other mutual funds whose shares Vance, Sanders distributes (Exhibit C), constitutes the entire agreement between MIGS and Vance, Sanders with respect to the purchase, sale and redemption of MIGS shares; there are no oral agreements. Vance Sanders has been free at all times to conduct its business as it wishes. There are no provisions, explicit or otherwise, which prohibit Vance, Sanders from executing brokerage transactions in MIGS shares.

3. Neither MIGS nor its investment advisor, Massachusetts Financial Services, Inc., is affiliated with Vance, Sanders in any way except for MIGS' use of Vance, Sanders as its principal underwriter. MIGS has, in fact, for reasons wholly unrelated to this litigation, given notice, effective June 30, 1973, of the termination of its distribution agreement with Vance, Sanders (Exhibit D).

/s/ John Barnard, Jr.
JOHN BARNARD, JR.

(Jurat Omitted in Printing)

DISTRIBUTION AGREEMENT

AGREEMENT made this twenty-first day of November, 1969, between Massachusetts Investors Growth Stock Fund, Inc., a Massachusetts corporation having principal place of business in Boston in the Commonwealth of Massachusetts, hereinafter called the "Fund", and Vance, Sanders & Company, Inc., a Maryland corporation having its principal place of business in said Boston, hereinafter sometimes called the "Principal Underwriter";

WHEREAS the Fund and the Principal Underwriter desire to replace the existing Agreement between them dated January 17, 1969, with a new Agreement;

NOW, THEREFORE, in consideration of the mutual promises and undertakings herein contained, the parties hereto agree:

1. The Fund grants to the Principal Underwriter the right to purchase shares of the Fund upon the terms hereinbelow set forth during the term of this Agreement. While this Agreement is in force, the Principal Underwriter agrees to use its best efforts to find purchasers for shares of the Fund.

The Principal Underwriter shall have the right to buy from the Fund the shares needed, but not more than the shares needed (except for clerical errors and errors of transmission) to fill unconditional orders for shares of the Fund placed with the Principal Underwriter by dealers or investors as set forth in the current prospectus relating to shares of the Fund. The price which the Principal Underwriter shall pay for the shares so purchased from the Fund shall be the net asset value used in determining the public offering price on which such orders were based. The Principal Underwriter shall notify the State Street Bank and Trust Company, Custodian and Agent of the Fund, at the end of each business day, or as soon thereafter as the orders placed with it have been compiled, of the number of shares and the prices thereof which the Principal Underwriter is to purchase as principal for resale. The Principal Underwriter shall take down and pay for shares ordered from the Fund on or before the seventh business day (excluding Saturdays) after the shares have been so ordered.

The right granted to the Principal Underwriter to buy shares from the Fund shall be exclusive, except that said

exclusive right shall not apply to shares issued in connection with the merger or consolidation of any other investment company or personal holding company with the Fund or the acquisition by purchase or otherwise of all (or substantially all) the assets or the outstanding shares of any such company, by the Fund; nor shall it apply to shares issued by the Fund in distribution of realized capital gains of the Fund payable in shares or in cash at the option of the shareholder.

2. The shares may be resold by the Principal Underwriter to dealers having sales agreements with the Principal Underwriter, and to investors, upon the following terms and conditions:

The public offering price, i.e., the price per share at which the Principal Underwriter or dealer purchasing shares from the Principal Underwriter may sell shares to the public, shall be the public offering price as set forth in the current Prospectus relating to said shares, but not to exceed the net asset value at which the Principal Underwriter is to purchase the shares, plus a sales charge not to exceed 8.5% of the public offering price (the net asset value divided by .915). If the resulting public offering price does not come out to an even cent, the public offering price shall be adjusted to the nearest cent.

The Principal Underwriter may also sell shares to Directors, officers and full-time employees of the Fund or of the Principal Underwriter or of any investment adviser of the Fund who have been such for 90 days, or to any trust, pension, profit-sharing or other benefit plan for such persons at the net asset value at which the Principal Underwriter is to purchase the shares (as established pursuant to paragraph 1 above) if the purchaser from the Principal Underwriter represents in writing that the shares are being acquired for investment purposes and agrees that such shares will not be resold except to the Fund.

The net asset value of shares of the Fund shall be determined by the Fund or State Street Bank and Trust Company as the agent of the Fund, as of the close of the New York Stock Exchange on each business day on which said Exchange is open, in accordance with the method set forth in the governing instruments (as hereinafter defined) of the Fund. The Fund may also cause the net asset value to be determined in substantially the same manner or esti-

mated in such manner and as of such other hour or hours as may from time to time be agreed upon in writing by the Fund and Principal Underwriter. The Fund shall have the right to suspend the sale of its shares if, because of some extraordinary condition, the New York Stock Exchange shall be closed, or if, in the judgment of a majority of the members of the Investment Management Committee of the Board of Directors of the Fund, conditions obtaining during the hours when said Exchange is open render such action advisable.

3. The Fund agrees that it will, from time to time, but subject to the necessary approval of the shareholders, take all necessary action to fix the number of authorized shares and such steps as may be necessary to register the same under the Federal Securities Act of 1933 (as amended from time to time) to the end that there will be available for sale such number of shares as the Principal Underwriter may reasonably be expected to sell. The Fund agrees to indemnify and hold harmless the Principal Underwriter and each person, if any, who controls the Principal Underwriter within the meaning of Section 15 of the Securities Act of 1933 against any loss, liability, claim, damages or expense (including the reasonable cost of investigating or defending any alleged loss, liability, claim, damages or expense and reasonable counsel fees incurred in connection therewith), arising by reason of any person acquiring any shares, which may be based upon the Securities Act of 1933 or on any other statute or at common law, on the ground that the registration statement or Prospectus, as from time to time amended and supplemented, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein not misleading, unless such statement or omission was made in reliance upon, and in conformity with, information furnished in writing to the Fund in connection therewith by or on behalf of the Principal Underwriter; provided, however, that in no case (i) is the indemnity of the Fund in favor of the Principal Underwriter and any such controlling person to be deemed to protect such Principal Underwriter or any such controlling person against any liability to the Fund or its security holders to which such Principal Underwriter or any such controlling person would otherwise be subject by reason

of willful misfeasance, bad faith, or gross negligence, in the performance of its duties or by reason of its reckless disregard of its obligations and duties under this Agreement, or (ii) is the Fund to be liable under its indemnity agreement contained in this paragraph with respect to any claim made against the Principal Underwriter or any such controlling person unless the Principal Underwriter or such controlling person, as the case may be, shall have notified the Fund in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon the Principal Underwriter or such controlling person (or after such Principal Underwriter or such controlling person shall have received notice of such service on any designated agent), but failure to notify the Fund of any such claim shall not relieve it from any liability which it may have to the person against whom such action is brought otherwise than on account of its indemnity agreement contained in this paragraph. The Fund shall be entitled to participate, at its own expense, in the defense, or, if it so elects, to assume the defense of any suit brought to enforce any such liability, but if the Fund elects to assume the defense, such defense shall be conducted by counsel chosen by it and satisfactory to the Principal Underwriter or controlling person or persons, defendant or defendants in the suit. In the event the Fund elects to assume the defense of any such suit and retain such counsel, the Principal Underwriter or controlling person or persons, defendant or defendants in the suit, shall bear the fees and expenses of any additional counsel retained by them, but, in case the Fund does not elect to assume the defense of any such suit, it shall reimburse the Principal Underwriter or controlling person or persons, defendant or defendants in the suit, for the reasonable fees and expenses of any counsel retained by them. The Fund agrees promptly to notify the Principal Underwriter of the commencement of any litigation or proceedings against it or any of its officers or Directors in connection with the issuance or sale of any of the shares.

4. The Principal Underwriter covenants and agrees that, in selling the shares of the Fund, it will use its best efforts in all respects duly to conform with the requirements of all state and federal laws relating to the sale of such securities, and will indemnify and hold harmless the Fund and each

of its Directors and officers and each person, if any, who controls the Fund within the meaning of Section 15 of the Securities Act of 1933, against any loss, liability, damages, claim or expense (including the reasonable cost of investigating or defending any alleged loss, liability, damages, claim or expense and reasonable counsel fees incurred in connection therewith), arising by reason of any person acquiring any shares, which may be based upon the Securities Act of 1933 or any other statute or at common law, on account of any wrongful act of the Principal Underwriter or any of its employees (including any failure to conform with any requirement of any state or federal law relating to the sale of such securities) or on the ground that the registration statement or Prospectus, as from time to time amended and supplemented, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein not misleading, in so far as any such statement or omission was made in reliance upon, and in conformity with information furnished in writing to the Fund in connection therewith by or on behalf of the Principal Underwriter, provided, however, that in no case (i) is the indemnity of the Principal Underwriter in favor of any person indemnified to be deemed to protect the Fund or any such person against any liability to which the Fund or any such person would otherwise be subject by reason of willful misfeasance, bad faith, or gross negligence, in the performance of its or his duties or by reason of its or his reckless disregard of its obligations and duties under this Agreement, or (ii) is the Principal Underwriter to be liable under its indemnity agreement contained in this paragraph with respect to any claim made against the Fund or any person indemnified unless the Fund or such person, as the case may be, shall have notified the Principal Underwriter in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon the Fund or upon such person (or after the Fund or such person shall have received notice of such service on any designated agent), but failure to notify the Principal Underwriter of any such claim shall not relieve it from any liability which it may have to the Fund or any person against whom such action is brought otherwise than on account of its indemnity

agreement contained in this paragraph. The Principal Underwriter shall be entitled to participate, at its own expense, in the defense, or, if it so elects, to assume the defense of any suit brought to enforce any such liability, but, if the Principal Underwriter elects to assume the defense, such defense shall be conducted by counsel chosen by it and satisfactory to the Fund, or to its officers or Directors, or to any controlling person or persons, defendant or defendants in the suit. In the event that the Principal Underwriter elects to assume the defense of any such suit and retain such counsel, the Fund or such officers or Directors or controlling person or persons, defendant or defendants in the suit, shall bear the fee and expenses of any additional counsel retained by them, but, in case the Principal Underwriter does not elect to assume the defense of any such suit, it shall reimburse the Fund and such officers and Directors or controlling person or persons, defendant or defendants in such suit, for the reasonable fees and expenses of any counsel retained by them. The Principal Underwriter agrees promptly to notify the Fund of the commencement of any litigation or proceedings against it in connection with the issue and sale of any of the shares.

Neither the Principal Underwriter nor any dealer nor any other person is authorized by the Fund to give any information or to make any representations, other than those contained in the Registration Statement or Prospectus filed with the Securities and Exchange Commission under the Securities Act of 1933, as amended (as said Registration Statement and Prospectus may be amended or supplemented from time to time), covering the shares of the Fund. Neither the Principal Underwriter nor any dealer nor any other person is authorized to act as agent for the Fund in connection with the offering or sale of shares of the Fund to the public or otherwise. All such sales made by the Principal Underwriter shall be made by it as principal, for its own account. The Principal Underwriter may, however, act as agent in connection with the repurchase of shares as provided in paragraph 6 below, or in connection with "exchanges" between investment companies sponsored by the Principal Underwriter as provided in the agreement or agreements among such companies as from time to time in effect.

5. The Fund will pay, or cause to be paid—

(i) all the costs and expenses of the Fund, including fees and disbursements of its counsel, in connection with the preparation and filing of any required Registration Statement and/or Prospectus under the Securities Act of 1933, as amended, covering its shares and all amendments and supplements thereto, and preparing and mailing periodic reports to shareholders (including the expense of setting up in type any such Registration Statement, Prospectus or periodic report);

(ii) the cost of preparing temporary and permanent stock certificates for shares of the Fund;

(iii) the cost and expenses of delivering to the Principal Underwriter at its office in Boston, Massachusetts, all shares purchased by it as principal hereunder;

(iv) all the federal and state issue and/or transfer taxes payable upon the issue by or (in the case of treasury shares) transfer from the Fund to the Principal Underwriter of any and all shares purchased by the Principal Underwriter hereunder.

The Principal Underwriter agrees that, after the Prospectus and periodic reports have been set up in type, it will bear the expense of printing and distributing any copies thereof which are to be used in connection with the offering of shares to dealers or investors. The Principal Underwriter further agrees that it will bear the expenses of preparing, printing and distributing any other literature used by the Principal Underwriter or furnished by it for use by dealers in connection with the offering of the shares for sale to the public, any expenses of advertising in connection with such offering, and the expenses (other than auditing expense) of qualification of the shares for sale, and, if necessary or advisable in connection therewith, of qualifying the Fund as a dealer or broker, in such states as shall be selected by the Principal Underwriter and the fees payable to each such state for continuing the qualification therein until the Principal Underwriter notifies the Fund that it does not wish such qualification continued.

6. The Fund hereby authorizes the Principal Underwriter to repurchase, upon the terms and conditions set forth in written instructions given by the Fund to the Principal Underwriter from time to time, as agent of the Fund and for its account, such shares of the Fund as may be offered for sale to the Fund from time to time.

(a) The Principal Underwriter shall notify in writing State Street Bank and Trust Company, Custodian of the Fund, at the end of each business day, or as soon thereafter as the repurchases have been compiled, of the number of shares repurchased for the account of the Fund since the last previous report, together with the prices at which such repurchases were made, and upon the request of any Director of the Fund shall furnish similar information with respect to all repurchases made up to the time of the request on any day.

(b) The Fund reserves the right to suspend or revoke the foregoing authorization at any time; unless otherwise stated, any such suspension or revocation shall be effective forthwith upon receipt of notice thereof by an officer of the Principal Underwriter, by telegraph or by written instrument from any two members of the Investment Management Committee of the Board of Directors of the Fund. In the event that the authorization of the Principal Underwriter is, by the terms of such notice, suspended for more than twenty-four hours or until further notice, the authorization given by this paragraph 6 shall not be revived except by action of a majority of the members of said Investment Management Committee.

(c) The Principal Underwriter shall have the right to terminate the operation of this paragraph 6 upon giving to the Fund thirty (30) days' written notice thereof.

(d) The Fund agrees to authorize and direct State Street Bank and Trust Company of Boston, Custodian, to pay, for the account of the Fund, the purchase price of any shares so repurchased against delivery of the certificates in proper form for transfer to the Fund or for cancellation by the Fund.

(e) The Principal Underwriter shall receive no commission in respect of any repurchase of shares under the foregoing authorization and appointment as agent.

(f) The Fund agrees to reimburse the Principal Underwriter, from time to time upon demand, for any reasonable expenses incurred in connection with the repurchase of shares pursuant to this paragraph 6.

7. If, at any time during the existence of this Agreement, the Fund shall deem it necessary or advisable in the best interests of the Fund that any amendment of this Agreement be made in order to comply with the recommendations

or requirements of the Securities and Exchange Commission or other governmental authority or to obtain any advantage under Massachusetts or federal tax laws, and shall notify the Principal Underwriter of the form of amendment which it deems necessary or advisable and the reasons therefor, and, if the Principal Underwriter declines to assent to such amendment, the Fund may terminate this Agreement forthwith by written notice to the Principal Underwriter. If, at any time during the existence of this Agreement, upon request by the Principal Underwriter, the Fund fails (after a reasonable time) to make any changes in its governing instruments or in its methods of doing business which are necessary in order to comply with any requirements of federal law or regulations of the Securities and Exchange Commission or of a national securities association of which the Principal Underwriter is or may be a member, relating to the sale of the shares of the Fund, the Principal Underwriter may terminate this Agreement forthwith by written notice to the Fund.

8. The Principal Underwriter agrees that it will not take any long or short positions in the shares of the Fund except as permitted by paragraphs 1 and 6 hereof and that, so far as it can control the situation, it will prevent any officer, Director or owner of voting common stock of the Principal Underwriter from taking any long or short position in the shares of the Fund, except as permitted by this Agreement or the governing instruments of the Fund. Whenever used in this Agreement, the term "governing instruments" shall mean the Articles of Organization and the By-Laws of the Fund, as from time to time amended.

9. The Agreement dated January 17, 1969, is hereby terminated effective the opening of business on the date of this Agreement, and the relations between the parties hereto thereafter will be governed by the terms of this Agreement. This Agreement shall continue in force until terminated as in this Agreement above provided, except:

(a) that this Agreement shall continue in effect for a period of more than two (2) years from the date of its execution only so long as such continuance is specifically approved at least annually by the Board of Directors of the Fund or by vote of a majority of the outstanding voting securities of the Fund; and

(b) that either party shall have the right to terminate

this Agreement on six (6) months' written notice thereof given in writing to the other.

10. In the event of the assignment (as defined in Section 2(a)(4) of the Investment Company Act of 1940) of this Agreement by the Principal Underwriter, this Agreement shall automatically terminate.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the day and year first written.

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

By ______________________________

VANCE, SANDERS & COMPANY, INC.

By ______________________________

President

November 21, 1969

Vance, Sanders & Company, Inc.
111 Devonshire Street
Boston, Massachusetts 02109

Gentlemen:

Massachusetts Investors Growth Stock Fund, Inc. (the "Fund") refers you to paragraph 6 of the Distribution Agreement between you and the Fund dated as of November 21, 1969, pursuant to which the Fund has authorized you to repurchase, upon the terms and conditions set forth in written instructions given by the Fund to you from time to time, as agent of the Fund and for its account, such shares of the Fund as may be offered for sale to the Fund from time to time.

As agent of the Fund you may accept offers from an investment dealer to sell such shares (1) at a price not exceeding the net asset value of such shares determined next after the receipt of the order by the dealer from his customer if such offer is received by you prior to either your close of business that day or the time the net asset value is next determined, whichever occurs first, or (2) at a price not exceeding the net asset value of such shares determined at such later time as may be stipulated by the dealer.

As agent of the Fund you may also accept offers from a shareholder of record (including an offer from an agent of such shareholder), to sell such shares (1) at a price not exceeding the net asset value of such shares determined next after the receipt of the offer by you, or (2) at a price not exceeding the net asset value of such shares determined at such later time as may be stipulated by such shareholder or agent.

Very truly yours,

MASSACHUSETTS INVESTORS
GROWTH STOCK FUND, INC.

By ______________________________

Secretary

AGREEMENT

THIS AGREEMENT made as of the 1st day of January, 1972, by and among Massachusetts Investors Trust ("MIT"), Massachusetts Investors Growth Stock Fund, Inc. ("MIG"), Massachusetts Income Development Fund, Inc. ("MID"), Massachusetts Capital Development Fund, Inc. ("MCD") and Massachusetts Financial Development Fund, Inc. ("MFD") (MIT, MIG, MID, MCD and MFD herein collectively called the "Funds") and Vance, Sanders & Company, Inc. (herein called the "General Distributor").

WITNESSETH THAT:

WHEREAS, pursuant to the terms of the General Distribution Agreements between each Fund and the General Distributor, the General Distributor has the exclusive right to purchase from the Funds shares of each Fund at the net asset value used in determining the public offering price on which orders for shares were based, but subject to the exceptions therein set forth or referred to;

WHEREAS, MIT and MIG are parties to an agreement dated August 1, 1966 (the "1966 Agreement") and MID is a party to an agreement dated April 1, 1971 (the "1971 Agreement"), making available to existing and future shareholders of MIT, MIG and MID the opportunity to implement changes in their investment objectives through the acquisition, without sales charge, of the shares of one or more of those funds by use of the proceeds of redemption of shares of another of such funds;

WHEREAS, the Funds have differing investment objectives as set out in their offering prospectuses, and consider it appropriate to make available to existing and future shareholders of the Funds the opportunity to implement changes in their investment objectives through the acquisition, without sales charge, of the shares of any one or more of the Funds by use of the proceeds of redemption of shares of any other Fund (herein referred to in various grammatical forms of the word "exchange"), subject to reasonable conditions designed to limit expense and administrative inconvenience;

WHEREAS, the General Distributor currently acts as the principal underwriter of the Funds; and

WHEREAS, the Funds and the General Distributor desire to continue to make exchanges permitted by the 1966 Agreement and the 1971 Agreement available to the shareholders of MIT, MIG, and MID and to extend the offer of exchange to the shareholders of MCD and MFD by means of a single agreement which replaces the 1971 Agreement and, with respect to the rights and obligations of MIT and MIG to each other, replaces the 1966 Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

1. During the term of this Agreement shares of each of the Funds may be offered by the General Distributor as principal at net asset value to shareholders of each of the Funds who wish to apply the proceeds of redemption of shares of any one or more of the Funds to the acquisition of shares of any one or more of the Funds under the following circumstances:

(a) The shareholder has held at least 80% in value of the shares to be exchanged for at least six months, including, in the case of the estate of a deceased shareholder or the heirs or legatees of a deceased shareholder, the period during which the shares were held by the decedent.

(b) The net asset value of the shares to be redeemed in the exchange is at least $1,000.

2. The General Distributor shall process all exchanges in the usual manner as though they were unrelated repurchases and sales. The General Distributor may charge the shareholder a reasonable amount for its services in effecting the exchange. The General Distributor shall report daily to the investment companies concerned all exchanges made pursuant to this Agreement. The General Distributor will not seek reimbursement from the Funds for any expenses incurred by it in connection with any such repurchases.

3. Each of the Funds may, by written notice to each of the other Funds and the General Distributor terminate its exchange offer provided by this Agreement and require the General Distributor and the other Funds to terminate the exchange offer in respect of the shares of the Fund so giving notice. The General Distributor may by written notice to any Fund terminate its services in effecting such exchanges on behalf of such Fund. The exchange offers with respect to shares of a Fund made by the General

Distributor to the shareholders of the Funds pursuant to this Agreement shall in any event be terminated effective upon the termination of the services of the General Distributor as principal underwriter of the shares of such Fund.

4. Nothing in this Agreement shall modify or reduce the obligations of a Fund or the General Distributor contained in the General Distribution Agreement between the General Distributor and such Fund as the same may from time to time be modified and amended.

5. The terms of this Agreement shall become effective as of the date first written above and replace the 1971 Agreement, and, with respect to the rights and obligations of MIT and MIG to each other, the 1966 Agreement, except that the privilege of exchanging shares of MIT, MIG, MID and MCD for shares of MFD and the privilege of exchanging shares of MFD for shares of MIT, MIG, MID and MCD shall not become effective until April 1, 1972.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written and caused their seals to be affixed by their representatives thereunto duly authorized.

MASSACHUSETTS INVESTORS TRUST

Attest: ____________________ By ____________________

Secretary — Managing Trustee

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

Attest: ____________________ By ____________________

Clerk — Vice President

MASSACHUSETTS INCOME DEVELOPMENT FUND, INC.

Attest: ____________________ By ____________________

Secretary — Vice President

MASSACHUSETTS CAPITAL DEVELOPMENT FUND, INC.

Attest: ____________________ By ____________________

Secretary — Vice President

MASSACHUSETTS FINANCIAL DEVELOPMENT FUND, INC.

Attest: ______________________ By ______________________
Secretary Vice President

VANCE, SANDERS & COMPANY, INC.

Attest: ______________________ By ______________________
Secretary Vice President

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.
200 Berkeley Street
Boston, Massachusetts 02116
(617) 542-8225

Vance, Sanders, & Company, Inc.
111 Devonshire Street
Boston
Massachusetts 02109

November 21, 1972

Gentlemen:

In accordance with Section 9 of the Distribution Agreement between you and us dated November 21, 1969, you are hereby notified that the undersigned hereby exercises its right to terminate such agreement effective at the close of business June 30, 1973.

Please acknowledge receipt of this notice by signing and returning the enclosed copy of this letter.

Very truly yours,
MASSACHUSETTS INVESTORS GROWTH STOCK FUND INC.

By /s/ Tarrant Cutler
Tarrant Cutler
Secretary

Notice of termination received
this 24th day of November, 1972.
VANCE, SANDERS & COMPANY, INC.

By /s/ John D. Wilson

(Title Omitted in Printing)

COMMONWEALTH OF MASSACHUSETTS }
COUNTY OF SUFFOLK } ss.:

THOMAS OTIS, being duly sworn, deposes and says:

1. I am an attorney and am Vice President of Vance, Sanders & Company, Inc. ("Vance, Sanders").

2. Attached hereto are the following exhibits: Exhibit A, being the Distribution Agreement dated November 21, 1969 between Vance, Sanders and Massachusetts Investors Growth Stock Fund, Inc. ("MIGS"); Exhibit B, being a letter of instruction dated November 21, 1969 from MIGS to Vance, Sanders; and Exhibit C, being the Exchange Agreement dated January 1, 1972 between Vance, Sanders and MIGS, Massachusetts Investors Trust, Massachusetts Income Development Fund, Inc., Massachusetts Capital Development Fund, Inc. and Massachusetts Financial Development Fund, Inc. There are no provisions, explicit or otherwise, in such Exhibits which prohibt Vance, Sanders from executing brokerage transactions in MIGS shares. There are no other contracts, understandings or agreements between Vance, Sanders and MIGS which would prohibit Vance, Sanders from executing brokerage transactions in MIGS shares.

THOMAS OTIS

(Jurat Omitted in Printing)

DISTRIBUTION AGREEMENT

AGREEMENT made this twenty-first day of November, 1969, between Massachusetts Investors Growth Stock Fund, Inc., a Massachusetts corporation having principal place of business in Boston in the Commonwealth of Massachusetts, hereinafter called the "Fund", and Vance, Sanders & Company, Inc., a Maryland corporation having its principal place of business in said Boston, hereinafter sometimes called the "Principal Underwriter";

WHEREAS the Fund and the Principal Underwriter desire to replace the existing Agreement between them dated January 17, 1969, with a new Agreement;

NOW, THEREFORE, in consideration of the mutual promises and undertakings herein contained, the parties hereto agree:

1. The Fund grants to the Principal Underwriter the right to purchase shares of the Fund upon the terms hereinbelow set forth during the term of this Agreement. While this Agreement is in force, the Principal Underwriter agrees to use its best efforts to find purchasers for shares of the Fund.

The Principal Underwriter shall have the right to buy from the Fund the shares needed, but not more than the shares needed (except for clerical errors and errors of transmission) to fill unconditional orders for shares of the Fund placed with the Principal Underwriter by dealers or investors as set forth in the current prospectus relating to shares of the Fund. The price which the Principal Underwriter shall pay for the shares so purchased from the Fund shall be the net asset value used in determining the public offering price on which such orders were based. The Principal Underwriter shall notify the State Street Bank and Trust Company, Custodian and Agent of the Fund, at the end of each business day, or as soon thereafter as the orders placed with it have been compiled, of the number of shares and the prices thereof which the Principal Underwriter is to purchase as principal for resale. The Principal Underwriter shall take down and pay for shares ordered from the Fund on or before the seventh business day (excluding Saturdays) after the shares have been so ordered.

The right granted to the Principal Underwriter to buy shares from the Fund shall be exclusive, except that said exclusive right shall not apply to shares issued in connec-

tion with the merger or consolidation of any other investment company or personal holding company with the Fund or the acquisition by purchase or otherwise of all (or substantially all) the assets or the outstanding shares of any such company, by the Fund; nor shall it apply to shares issued by the Fund in distribution of realized capital gains of the Fund payable in shares or in cash at the option of the shareholder.

2. The shares may be resold by the Principal Underwriter to dealers having sales agreements with the Principal Underwriter, and to investors, upon the following terms and conditions:

The public offering price, i.e., the price per share at which the Principal Underwriter or dealer purchasing shares from the Principal Underwriter may sell shares to the public, shall be the public offering price as set forth in the current Prospectus relating to said shares, but not to exceed the net asset value at which the Principal Underwriter is to purchase the shares, plus a sales charge not to exceed 8.5% of the public offering price (the net asset value divided by .915). If the resulting public offering price does not come out to an even cent, the public offering price shall be adjusted to the nearest cent.

The Principal Underwriter may also sell shares to Directors, officers and full-time employees of the Fund or of the Principal Underwriter or of any investment adviser of the Fund who have been such for 90 days, or to any trust, pension, profit-sharing or other benefit plan for such persons at the net asset value at which the Principal Underwriter is to purchase the shares (as established pursuant to paragraph 1 above) if the purchaser from the Principal Underwriter represents in writing that the shares are being acquired for investment purposes and agrees that such shares will not be resold except to the Fund.

The net asset value of shares of the Fund shall be determined by the Fund or State Street Bank and Trust Company as the agent of the Fund, as of the close of the New York Stock Exchange on each business day on which said Exchange is open, in accordance with the method set forth in the governing instruments (as hereinafter defined) of the Fund. The Fund may also cause the net asset value to be determined in substantially the same manner or estimated in such manner and as of such other hour or hours

as may from time to time be agreed upon in writing by the Fund and Principal Underwriter. The Fund shall have the right to suspend the sale of its shares if, because of some extraordinary condition, the New York Stock Exchange shall be closed, or if, in the judgment of a majority of the members of the Investment Management Committee of the Board of Directors of the Fund, conditions obtaining during the hours when said Exchange is open render such action advisable.

3. The Fund agrees that it will, from time to time, but subject to the necessary approval of the shareholders, take all necessary action to fix the number of authorized shares and such steps as may be necessary to register the same under the Federal Securities Act of 1933 (as amended from time to time) to the end that there will be available for sale such number of shares as the Principal Underwriter may reasonably be expected to sell. The Fund agrees to indemnify and hold harmless the Principal Underwriter and each person, if any, who controls the Principal Underwriter within the meaning of Section 15 of the Securities Act of 1933 against any loss, liability, claim, damages or expense (including the reasonable cost of investigating or defending any alleged loss, liability, claim, damages or expense and reasonable counsel fees incurred in connection therewith), arising by reason of any person acquiring any shares, which may be based upon the Securities Act of 1933 or on any other statute or at common law, on the ground that the registration statement or Prospectus, as from time to time amended and supplemented, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein not misleading, unless such statement or omission was made in reliance upon, and in conformity with, information furnished in writing to the Fund in connection therewith by or on behalf of the Principal Underwriter; provided, however, that in no case (i) is the indemnity of the Fund in favor of the Principal Underwriter and any such controlling person to be deemed to protect such Principal Underwriter or any such controlling person against any liability to the Fund or its security holders to which such Principal Underwriter or any such controlling person would otherwise be subject by reason of willful misfeasance, bad faith, or gross negligence, in

the performance of its duties or by reason of its reckless disregard of its obligations and duties under this Agreement, or (ii) is the Fund to be liable under its indemnity agreement contained in this paragraph with respect to any claim made against the Principal Underwriter or any such controlling person unless the Principal Underwriter or such controlling person, as the case may be, shall have notified the Fund in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon the Principal Underwriter or such controlling person (or after such Principal Underwriter or such controlling person shall have received notice of such service on any designated agent), but failure to notify the Fund of any such claim shall not relieve it from any liability which it may have to the person against whom such action is brought otherwise than on account of its indemnity agreement contained in this paragraph. The Fund shall be entitled to participate, at its own expense, in the defense, or, if it so elects, to assume the defense of any suit brought to enforce any such liability, but if the Fund elects to assume the defense, such defense shall be conducted by counsel chosen by it and satisfactory to the Principal Underwriter or controlling person or persons, defendant or defendants in the suit. In the event the Fund elects to assume the defense of any such suit and retain such counsel, the Principal Underwriter or controlling person or persons, defendant or defendants in the suit, shall bear the fees and expenses of any additional counsel retained by them, but, in case the Fund does not elect to assume the defense of any such suit, it shall reimburse the Principal Underwriter or controlling person or persons, defendant or defendants in the suit, for the reasonable fees and expenses of any counsel retained by them. The Fund agrees promptly to notify the Principal Underwriter of the commencement of any litigation or proceedings against it or any of its officers or Directors in connection with the issuance or sale of any of the shares.

4. The Principal Underwriter covenants and agrees that, in selling the shares of the Fund, it will use its best efforts in all respects duly to conform with the requirements of all state and federal laws relating to the sale of such securities, and will indemnify and hold harmless the Fund and each of its Directors and officers and each person, if any, who

controls the Fund within the meaning of Section 15 of the Securities Act of 1933, against any loss, liability, damages, claim or expense (including the reasonable cost of investigating or defending any alleged loss, liability, damages, claim or expense and reasonable counsel fees incurred in connection therewith), arising by reason of any person acquiring any shares, which may be based upon the Securities Act of 1933 or any other statute or at common law, on account of any wrongful act of the Principal Underwriter or any of its employees (including any failure to conform with any requirement of any state or federal law relating to the sale of such securities) or on the ground that the registration statement or Prospectus, as from time to time amended and supplemented, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein not misleading, in so far as any such statement or omission was made in reliance upon, and in conformity with information furnished in writing to the Fund in connection therewith by or on behalf of the Principal Underwriter, provided, however, that in no case (i) is the indemnity of the Principal Underwriter in favor of any person indemnified to be deemed to protect the Fund or any such person against any liability to which the Fund or any such person would otherwise be subject by reason of willful misfeasance, bad faith, or gross negligence, in the performance of its or his duties or by reason of its or his reckless disregard of its obligations and duties under this Agreement, or (ii) is the Principal Underwriter to be liable under its indemnity agreement contained in this paragraph with respect to any claim made against the Fund or any person indemnified unless the Fund or such person, as the case may be, shall have notified the Principal Underwriter in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon the Fund or upon such person (or after the Fund or such person shall have received notice of such service on any designated agent), but failure to notify the Principal Underwriter of any such claim shall not relieve it from any liability which it may have to the Fund or any person against whom such action is brought otherwise than on account of its indemnity agreement contained in this paragraph. The Principal

Underwriter shall be entitled to participate, at its own expense, in the defense, or, if it so elects, to assume the defense of any suit brought to enforce any such liability, but, if the Principal Underwriter elects to assume the defense, such defense shall be conducted by counsel chosen by it and satisfactory to the Fund, or to its officers or Directors, or to any controlling person or persons, defendant or defendants in the suit. In the event that the Principal Underwriter elects to assume the defense of any such suit and retain such counsel, the Fund or such officers or Directors or controlling person or persons, defendant or defendants in the suit, shall bear the fee and expenses of any additional counsel retained by them, but, in case the Principal Underwriter does not elect to assume the defense of any such suit, it shall reimburse the Fund and such officers and Directors or controlling person or persons, defendant or defendants in such suit, for the reasonable fees and expenses of any counsel retained by them. The Principal Underwriter agrees promptly to notify the Fund of the commencement of any litigation or proceedings against it in connection with the issue and sale of any of the shares.

Neither the Principal Underwriter nor any dealer nor any other person is authorized by the Fund to give any information or to make any representations, other than those contained in the Registration Statement or Prospectus filed with the Securities and Exchange Commission under the Securities Act of 1933, as amended (as said Registration Statement and Prospectus may be amended or supplemented from time to time), covering the shares of the Fund. Neither the Principal Underwriter nor any dealer nor any other person is authorized to act as agent for the Fund in connection with the offering or sale of shares of the Fund to the public or otherwise. All such sales made by the Principal Underwriter shall be made by it as principal, for its own account. The Principal Underwriter may, however, act as agent in connection with the repurchase of shares as provided in paragraph 6 below, or in connection with "exchanges" between investment companies sponsored by the Principal Underwriter as provided in the agreement or agreements among such companies as from time to time in effect.

5. The Fund will pay, or cause to be paid—

(i) all the costs and expenses of the Fund, including

fees and disbursements of its counsel, in connection with the preparation and filing of any required Registration Statement and/or Prospectus under the Securities Act of 1933, as amended, covering its shares and all amendments and supplements thereto, and preparing and mailing periodic reports to shareholders (including the expense of setting up in type any such Registration Statement, Prospectus or periodic report);

(ii) the cost of preparing temporary and permanent stock certificates for shares of the Fund;

(iii) the cost and expenses of delivering to the Principal Underwriter at its office in Boston, Massachusetts, all shares purchased by it as principal hereunder;

(iv) all the federal and state issue and/or transfer taxes payable upon the issue by or (in the case of treasury shares) transfer from the Fund to the Principal Underwriter of any and all shares purchased by the Principal Underwriter hereunder.

The Principal Underwriter agrees that, after the Prospectus and periodic reports have been set up in type, it will bear the expense of printing and distributing any copies thereof which are to be used in connection with the offering of shares to dealers or investors. The Principal Underwriter further agrees that it will bear the expenses of preparing, printing and distributing any other literature used by the Principal Underwriter or furnished by it for use by dealers in connection with the offering of the shares for sale to the public, any expenses of advertising in connection with such offering, and the expenses (other than auditing expense) of qualification of the shares for sale, and, if necessary or advisable in connection therewith, of qualifying the Fund as a dealer or broker, in such states as shall be selected by the Principal Underwriter and the fees payable to each such state for continuing the qualification therein until the Principal Underwriter notifies the Fund that it does not wish such qualification continued.

6. The Fund hereby authorizes the Principal Underwriter to repurchase, upon the terms and conditions set forth in written instructions given by the Fund to the Principal Underwriter from time to time, as agent of the Fund and for its account, such shares of the Fund as may be offered for sale to the Fund from time to time.

(a) The Principal Underwriter shall notify in writing

State Street Bank and Trust Company, Custodian of the Fund, at the end of each business day, or as soon thereafter as the repurchases have been compiled, of the number of shares repurchased for the account of the Fund since the last previous report, together with the prices at which such repurchases were made, and upon the request of any Director of the Fund shall furnish similar information with respect to all repurchases made up to the time of the request on any day.

(b) The Fund reserves the right to suspend or revoke the foregoing authorization at any time; unless otherwise stated, any such suspension or revocation shall be effective forthwith upon receipt of notice thereof by an officer of the Principal Underwriter, by telegraph or by written instrument from any two members of the Investment Management Committee of the Board of Directors of the Fund. In the event that the authorization of the Principal Underwriter is, by the terms of such notice, suspended for more than twenty-four hours or until further notice, the authorization given by this paragraph 6 shall not be revived except by action of a majority of the members of said Investment Management Committee.

(c) The Principal Underwriter shall have the right to terminate the operation of this paragraph 6 upon giving to the Fund thirty (30) days' written notice thereof.

(d) The Fund agrees to authorize and direct State Street Bank and Trust Company of Boston, Custodian, to pay, for the account of the Fund, the purchase price of any shares so repurchased against delivery of the certificates in proper form for transfer to the Fund or for cancellation by the Fund.

(e) The Principal Underwriter shall receive no commission in respect of any repurchase of shares under the foregoing authorization and appointment as agent.

(f) The Fund agrees to reimburse the Principal Underwriter, from time to time upon demand, for any reasonable expenses incurred in connection with the repurchase of shares pursuant to this paragraph 6.

7. If, at any time during the existence of this Agreement, the Fund shall deem it necessary or advisable in the best interests of the Fund that any amendment of this Agreement be made in order to comply with the recommendations or requirements of the Securities and Exchange Commis-

sion or other governmental authority or to obtain any advantage under Massachusetts or federal tax laws, and shall notify the Principal Underwriter of the form of amendment which it deems necessary or advisable and the reasons therefor, and, if the Principal Underwriter declines to assent to such amendment, the Fund may terminate this Agreement forthwith by written notice to the Principal Underwriter. If, at any time during the existence of this Agreement, upon request by the Principal Underwriter, the Fund fails (after a reasonable time) to make any change in its governing instruments or in its methods of doing business which are necessary in order to comply with any requirements of federal law or regulations of the Securities and Exchange Commission or of a national securities association of which the Principal Underwriter is or may be a member, relating to the sale of the shares of the Fund, the Principal Underwriter may terminate this Agreement forthwith by written notice to the Fund.

8. The Principal Underwriter agrees that it will not take any long or short positions in the shares of the Fund except as permitted by paragraphs 1 and 6 hereof and that, so far as it can control the situation, it will prevent any officer, Director or owner of voting common stock of the Principal Underwriter from taking any long or short position in the shares of the Fund, except as permitted by this Agreement or the governing instruments of the Fund. Whenever used in this Agreement, the term "governing instruments" shall mean the Articles of Organization and the By-Laws of the Fund, as from time to time amended.

9. The Agreement dated January 17, 1969, is hereby terminated effective the opening of business on the date of this Agreement, and the relations between the parties hereto thereafter will be governed by the terms of this Agreement. This Agreement shall continue in force until terminated as in this Agreement above provided, except:

(a) that this Agreement shall continue in effect for a period of more than two (2) years from the date of its execution only so long as such continuance is specifically approved at least annually by the Board of Directors of the Fund or by vote of a majority of the outstanding voting securities of the Fund; and

(b) that either party shall have the right to terminate

this Agreement on six (6) months' written notice thereof given in writing to the other.

10. In the event of the assignment (as defined in Section 2(a)(4) of the Investment Company Act of 1940) of this Agreement by the Principal Underwriter, this Agreement shall automatically terminate.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the day and year first written.

MASSACHUSETTS INVESTORS
GROWTH STOCK FUND, INC.

By ______________________________

VANCE, SANDERS & COMPANY,
INC.

By ______________________________

President

November 21, 1969

Vance, Sanders & Company, Inc.
111 Devonshire Street
Boston, Massachusetts 02109

Gentlemen:

Massachusetts Investors Growth Stock Fund, Inc. (the "Fund") refers you to paragraph 6 of the Distribution Agreement between you and the Fund dated as of November 21, 1969, pursuant to which the Fund has authorized you to repurchase, upon the terms and conditions set forth in written instructions given by the Fund to you from time to time, as agent of the Fund and for its account, such shares of the Fund as may be offered for sale to the Fund from time to time.

As agent of the Fund you may accept offers from an investment dealer to sell such shares (1) at a price not exceeding the net asset value of such shares determined next after the receipt of the order by the dealer from his customer if such offer is received by you prior to either your close of business that day or the time the net asset value is next determined, whichever occurs first, or (2) at a price not exceeding the net asset value of such shares determined at such later time as may be stipulated by the dealer.

As agent of the Fund you may also accept offers from a shareholder of record (including an offer from an agent of such shareholder), to sell such shares (1) at a price not exceeding the net asset value of such shares determined next after the receipt of the offer by you, or (2) at a price not exceeding the net asset value of such shares determined at such later time as may be stipulated by such shareholder or agent.

Very truly yours,

MASSACHUSETTS INVESTORS
GROWTH STOCK FUND, INC.

By ______________________________

Secretary

AGREEMENT

THIS AGREEMENT made as of the 1st day of January, 1972, by and among Massachusetts Investors Trust ("MIT"), Massachusetts Investors Growth Stock Fund, Inc. ("MIG"), Massachusetts Income Development Fund, Inc. ("MID"), Massachusetts Capital Development Fund, Inc. ("MCD") and Massachusetts Financial Development Fund, Inc. ("MFD") (MIT, MIG, MID, MCD and MFD herein collectively called the "Funds") and Vance, Sanders & Company, Inc. (herein called the "General Distributor").

WITNESSETH THAT:

WHEREAS, pursuant to the terms of the General Distribution Agreements between each Fund and the General Distributor, the General Distributor has the exclusive right to purchase from the Funds shares of each Fund at the net asset value used in determining the public offering price on which orders for shares were based, but subject to the exceptions therein set forth or referred to;

WHEREAS, MIT and MIG are parties to an agreement dated August 1, 1966 (the "1966 Agreement") and MID is a party to an agreement dated April 1, 1971 (the "1971 Agreement"), making available to existing and future shareholders of MIT, MIG and MID the opportunity to implement changes in their investment objectives through the acquisition, without sales charge, of the shares of one or more of those funds by use of the proceeds of redemption of shares of another of such funds;

WHEREAS, the Funds have differing investment objectives as set out in their offering prospectuses, and consider it appropriate to make available to existing and future shareholders of the Funds the opportunity to implement changes in their investment objectives through the acquisition, without sales charge, of the shares of any one or more of the Funds by use of the proceeds of redemption of shares of any other Fund (herein referred to in various grammatical forms of the word "exchange"), subject to reasonable conditions designed to limit expense and administrative inconvenience;

WHEREAS, the General Distributor currently acts as the principal underwriter of the Funds; and

WHEREAS, the Funds and the General Distributor desire to continue to make exchanges permitted by the 1966 Agreement and the 1971 Agreement available to the shareholders of MIT, MIG, and MID and to extend the offer of exchange to the shareholders of MCD and MFD by means of a single agreement which replaces the 1971 Agreement and, with respect to the rights and obligations of MIT and MIG to each other, replaces the 1966 Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

1. During the term of this Agreement shares of each of the Funds may be offered by the General Distributor as principal at net asset value to shareholders of each of the Funds who wish to apply the proceeds of redemption of shares of any one or more of the Funds to the acquisition of shares of any one or more of the Funds under the following circumstances:

(a) The shareholder has held at least 80% in value of the shares to be exchanged for at least six months, including, in the case of the estate of a deceased shareholder or the heirs or legatees of a deceased shareholder, the period during which the shares were held by the decedent.

(b) The net asset value of the shares to be redeemed in the exchange is at least $1,000.

2. The General Distributor shall process all exchanges in the usual manner as though they were unrelated repurchases and sales. The General Distributor may charge the shareholder a reasonable amount for its services in effecting the exchange. The General Distributor shall report daily to the investment companies concerned all exchanges made pursuant to this Agreement. The General Distributor will not seek reimbursement from the Funds for any expenses incurred by it in connection with any such repurchases.

3. Each of the Funds may, by written notice to each of the other Funds and the General Distributor terminate its exchange offer provided by this Agreement and require the General Distributor and the other Funds to terminate the exchange offer in respect of the shares of the Fund so giving notice. The General Distributor may by written notice to any Fund terminate its services in effecting such exchanges on behalf of such Fund. The exchange offers

with respect to shares of a Fund made by the General Distributor to the shareholders of the Funds pursuant to this Agreement shall in any event be terminated effective upon the termination of the services of the General Distributor as principal underwriter of the shares of such Fund.

4. Nothing in this Agreement shall modify or reduce the obligations of a Fund or the General Distributor contained in the General Distribution Agreement between the General Distributor and such Fund as the same may from time to time be modified and amended.

5. The terms of this Agreement shall become effective as of the date first written above and replace the 1971 Agreement, and, with respect to the rights and obligations of MIT and MIG to each other, the 1966 Agreement, except that the privilege of exchanging shares of MIT, MIG, MID and MCD for shares of MFD and the privilege of exchanging shares of MFD for shares of MIT, MIG, MID and MCD shall not become effective until April 1, 1972.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written and caused their seals to be affixed by their representatives thereunto duly authorized.

MASSACHUSETTS INVESTORS TRUST

Attest: ____________________ By ____________________
Secretary Managing Trustee

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

Attest: ____________________ By ____________________
Clerk Vice President

MASSACHUSETTS INCOME DEVELOPMENT FUND, INC.

Attest: ____________________ By ____________________
Secretary Vice President

MASSACHUSETTS CAPITAL DEVELOPMENT FUND, INC.

Attest: ____________________ By ____________________
Secretary Vice President

MASSACHUSETTS FINANCIAL DEVELOPMENT FUND, INC.

Attest: ______________________ By ______________________

Secretary Vice President

VANCE, SANDERS & COMPANY, INC.

Attest: ______________________ By ______________________

Secretary Vice President

(Title Omitted in Printing)

MOTION OF DEFENDANTS FIDELITY FUND, INC. AND THE CROSBY CORPORATION TO DISMISS THE COMPLAINT

Upon the complaint and answer herein and upon the affidavit of Caleb Loring sworn to May 23, 1973, and pursuant to Rules 12(b)(6) and (d) of the Federal Rules of Civil Procedure and Pretrial Orders Nos. 1 and 2 previously entered herein, defendants Fidelity Fund, Inc. and The Crosby Corporation hereby move to dismiss the complaint or appropriate parts thereof on the ground that they fail to state a claim upon which relief can be granted.

The grounds for the motion, more fully set forth in the accompanying memorandum of points and authorities, are that the acts, transactions, practices, and conduct complained of in the complaint are exempt from the antitrust laws by operation of the securities laws, including the Securities Exchange Act of 1934, the Investment Company Act of 1940, and orders, rules, regulations acts and practices thereunder, including those of the Securities and Exchange Commission and the National Association of Securities Dealers, Inc.

Respectfully submitted,

William R. Meagher
WILLIAM R. MEAGHER

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM
919 Third Avenue
New York, N. Y. 10022
(212) 371-6000

—and—

Daniel P. Levitt
DANIEL P. LEVITT

PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
1775 K Street, N. W., Suite 700
Washington, D. C. 20006
(202) 293-6370

Attorneys for Defendants Fidelity Fund, Inc. and The Crosby Corporation

OF COUNSEL:
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New York, N. Y. 10022

Leonard H. Becker

PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
1775 K Street, N. W., Suite 700
Washington, D. C. 20006

Dated: May 29, 1973

Affidavit of Caleb Loring, Jr.

(Title Omitted in Printing)

CALEB LORING, JR., being duly sworn, deposes and says:

1. I am the Assistant Secretary of The Crosby Corporation ("Crosby") a defendant herein, and am Vice President and Clerk of Fidelity Fund, Inc. ("Fidelity"), also a defendant herein. I am also Vice President, General Counsel and a Director of Fidelity Management and Research Company, which owns one hundred per cent of Crosby and is the investment advisor to Fidelity. In addition, I am Vice President of the other mutual funds in the "Fidelity Group".

2. I submit this affidavit in support of Crosby's and Fidelity's motion pursuant to pre-trial order No. 1 in this action for judgment dismissing the complaint or portions thereof on the ground that the activities complained of are exempt from the operations of the antitrust laws.

3. The purpose of this affidavit is to present to the Court the history of public filings made by Fidelity since its organization. There can be no dispute about these matters of public record.

4. Fidelity was organized prior to the passage of the Investment Company Act of 1940 ("1940 Act"). In its registration statement filed pursuant to the Securities Act of 1933 ("1933 Act"), effective December 9, 1937, one of the exhibits was the then existing underwriting agreement between the fund and its distributor, annexed hereto as Exhibit A. Since that time, the form of distribution agreement for the sale of Fidelity shares has been filed with the Securities and Exchange Commission ("SEC") under both the 1940 and 1933 Acts. Each agreement contains the provisions which the complaint alleges are violations of the antitrust laws.

5. Fidelity filed with its registration statement pursuant to Section 8 of the 1940 Act a specimen agreement between Paul H. Davis & Co., then principal underwriter for Fidelity, and the dealers in the Fidelity distribution system dated June 1, 1941. A copy of that agreement is annexed hereto as Exhibit B. Fidelity's quarterly and yearly reports pursuant to Section 30 of the 1940 Act filed in the ensuing thirty years have annexed or incorporated by reference the

underwriter-dealer agreement and reflected any changes therein. Copies of specimen agreements filed over this period are annexed hereto as Exhibit C.

6. The most recent sales agreement dated November 1, 1972 was annexed as an exhibit to the quarterly report filed under the 1940 Act for the quarter ended December 31, 1972. A copy of the current agreement is annexed hereto as Exhibit D and is also Exhibit A to the Crosby and Fidelity Answer in this action.

7. A review of all the agreements filed since 1941 shows that they have contained without substantial change the same language of which the Government complains in this action over since Fidelity's registration statement was first filed in 1941 and that the SEC has been continuously advised of these contractual provisions. In addition, Fidelity has filed the then current sales agreement as an exhibit or incorporated it by reference on some 16 amendments on Form S-5 to its 1933 Act registration.

8. As the Fidelity Group of funds has grown from one fund to several, the sales agreements have contained the same language, the only change herein relevant being the addition of one or another fund as it was organized. Thus, continuous and exhaustive filings have been made to apprise the SEC of the method of sale and distribution of all funds in the Fidelity Group since the SEC began administration of the 1940 Act.

Caleb Loring, Jr.

(Jurat Omitted in Printing)

EXHIBIT A

Agreement made this 26th day of July, 1937, between Fidelity Fund, Inc., a Massachusetts corporation having its principal place of business in Boston in said Commonwealth, (hereinafter called the Issuer), and Fidelity Distributors, Inc., a Massachusetts corporation having its principal place of business in said Boston, (hereinafter called the Underwriter),—

In consideration of the agreements herein set forth of the other party hereto, and in further consideration of the sum of one dollar and other valuable considerations to each paid by the other, the receipt whereof is hereby respectively acknowledged,

1. The Issuer hereby agrees as follows:

(a) During the life of this agreement to sell to the Underwriter from time to time as requested, and at the price hereinafter provided, one million (1,000,000) shares of its theretofore unissued Capital Stock—and, until such time as the Capital Stock outstanding amounts to one million (1,000,000) shares, all Capital Stock from time to time in the treasury, within the limits authorized in its Agreement of Association and Articles of Organization, as from time to time altered and amended, said shares upon payment therefor by the Underwriter to be issued in the name of the Underwriter; provided, however, that unless and until this agreement shall have been approved by the stockholders of the Issuer the obligation of the Issuer under this section (a) shall be deemed to be limited to the sum of (1) the number of shares of presently authorized but unissued Capital Stock and (2) the number of shares of Capital Stock now in the treasury; and provided further that in the event of any recapitalization resulting in there being outstanding a greater or lesser number of shares for each share of Capital Stock as now constituted said figure "1,000,000" and the figures "30,000" and "100,000" in section

(b) of Article 3 hereof shall be deemed to have been adjusted to offset any effect of said recapitalization on the real amount of capital stock covered by this agreement.

(b) During the life of this agreement not to sell shares of its Capital Stock except to the Underwriter.

(c) To furnish the Underwriter with reasonable promptness any and all information, financial statements and certificates which it may reasonably request for use in connection with the sale of shares of the Issuer's Capital Stock, provided, however, that in the case of any such information, financial statements and/or certificates of such character that they are not regularly prepared for stockholders the Underwriter agrees to pay the out-of-pocket expense of the Issuer and/or its investment counsel in the furnishing thereof.

(d) To determine from time to time during the life of this agreement, in accordance with the provisions of the then current prospectus approved by the Underwriter, the net asset value and the public offering price of the shares of its Capital Stock and promptly to communicate said determinations to the Underwriter.

2. The Underwriter hereby agrees as follows:

(a) To devote reasonable time and efforts to effecting sales of shares of the Issuer's Capital Stock and, without the written consent of the Issuer first obtained, to engage in no other business.

(b) To pay to the Issuer for each share of its Capital Stock sold to the Underwriter, upon the issuance thereof, the net asset value thereof as determined by the Issuer, and communicated by it to the Underwriter, in accordance with the provisions of section (d) of Article 1 of this agreement.

(c) The public offering price of the Issuer's Capital Stock so sold to the Underwriter shall be a sum per share determined from time to time by the Issuer, and communicated by it to the Underwriter, in accordance with the provisions of section (d) of Article 1 of this agreement, provided, however, that in the case of a single investment of $25,000 or more the Underwriter may at its option reduce or eliminate that part of the public offering price which is in excess of the liquidating value and which represents the loading charge.

(d) In, and in connection with, the sale of shares of the Issuer's Capital Stock, and in offering for sale, soliciting offers to buy, advertising and in general in attempting to dispose of, such shares, to comply with any and all statutes, orders, rules and regulations of any public authority which may be applicable thereto, and at no time to sell or permit to be sold, directly or through its salesmen, any shares of said Capital Stock in any manner inconsistent with any statement contained in the Registration Statement, as then last amended, and/or in the then last prospectus, filed with the Securities and Exchange Commission in respect of the Issuer's Capital Stock and/or inconsistent with any then existing Blue Sky qualification or exemption applicable to such stock, and to indemnify the Issuer against, and to exonerate and save it harmless from, any and all loss, liability and/or damage resulting from any violation by the Underwriter or its agents of any of the foregoing provisions of this section.

(e) To pay all costs and expenses arising in connection with the initial qualification of the Issuer's Capital Stock under the Blue Sky Laws of any states in which it may at any time or from time to time request the Issuer to qualify

such Capital Stock and, except as to each of such states in which there are at the time at least fifty (50) stockholders of record of the Issuer, all costs and expenses arising in connection with the continued maintenance of such qualification.

(f) Upon ceasing for any reason to be an underwriter of Capital Stock of the Issuer pursuant to this agreement, to cause the Underwriter's name to be so changed that the word "Fidelity" is no longer a part thereof.

(g) To provide, at its expense, all facilities necessary and/or appropriate to the liquidation by stockholders of the Issuer of stock in the Issuer by way of redemption thereof.

(h) To procure forthwith from each of its present stockholders a binding agreement in favor of the Issuer whereby it shall be the duty of the person from time to time the holder of such capital stock of the Underwriter (including, without hereby limiting the generality of the foregoing, the legal representatives of any deceased holder of such stock) who desires to sell or transfer any of such stock to any person or persons other than a then stockholder or then stockholders of the Underwriter, and of any grantee or assignee of any of such stock taken or transferred upon the insolvency or bankruptcy of the stockholder or by other process or operation of law or acquired by foreclosure of any pledge or hypothecation or in violation of any of the provisions of said agreement at least ninety (90), and not more than one hundred fifty (150), days prior to such proposed sale and/or transfer or acquisition, as the case may be, to offer in writing such stock to the Issuer for purchase by any nominee or nominees (who may be one or more of the then Directors of the Issuer) at the price determined as hereinafter provided,—the word "stockholder" whenever used in this section (h) being deemed to refer to and include such holder, grantee or assignee, as the case may be—and whereby such nominee or nominees may, unless the Directors of the Issuer shall have approved the sale and/or transfer, at any time within ninety (90) days after such offer is received by them elect to purchase said stock by notifying the stockholder of his or their election to purchase and delivering to said stockholder a binding agreement to pay the price of said stock, such price to be the amount of the proposed purchase price, in the case of any offer there-

under by reason of a bona fide offer to the stockholder to purchase for cash, and otherwise to be the then fair value thereof with any dispute as to the amount of such fair value to be settled by arbitration.

3. The Issuer and Underwriter hereby mutually agree as follows:

(a) In the event that any shares of the Issuer's Capital Stock are sold by the Underwriter or its agents in violation of the provisions of section (d) of Article 2 hereof, or in the event that the Underwriter shall fail or refuse to devote reasonable time and efforts to effecting sales of shares of the Issuer's Capital Stock, the Issuer may at its election terminate this agreement forthwith by giving written notice to the Underwriter.

(b) In the event that in any six months' period ending on December 31 or July 31 (but excluding December 31, 1937), during the term hereof the number of shares of Capital Stock purchased by the Underwriter from the Issuer pursuant to this agreement shall be less than 30,000, and/or in the event that in any annual period, ending on December 31, during the term hereof the number shall be less than 100,000, the Issuer may at its election terminate this agreement forthwith by giving written notice to the Underwriter.

(c) This agreement is personal to the parties hereto and non-assignable.

IN WITNESS WHEREOF said Fidelity Fund, Inc. has caused these presents to be signed and its corporate seal hereunto to be affixed by Albert L. Sylvester, its President thereunto duly authorized, and said Fidelity Distributors, Inc. has caused these presents to be signed and its corporate seal hereunto to be affixed by Richard N. Taliaferro, its President thereunto duly authorized, all on the day and year first above written.

FIDELITY FUND, INC.

(Corporate Seal) By Albert L. Sylvester

President

FIDELITY DISTRIBUTORS, INC.

(Corporate Seal) By Richard N. Taliaferro

President

EXHIBIT B

PAUL H. DAVIS & CO.
Established 1916
Members
New York Stock Exchange
Chicago Stock Exchange
Chicago Board of Trade
Associate Member
New York Curb Exchange

10 South La Salle Street
Telephone Franklin 8622
Chicago, Ill.

Merchants Bank Building
Telephone Market 2571
Indianapolis, Ind.

INVESTMENT DEPARTMENT
CHICAGO

June 1, 1941

General Distributors of
FIDELITY FUND

FIDELITY FUND, INC.
SALES AGREEMENT

We, as exclusive general distributors (and Principal Underwriter) of the shares of Fidelity Fund, Inc., agree to sell you shares of the Fund upon the following terms:

Retail Price and Bid Price:

The bid and regular public offering price of the shares determined as set forth in the Prospectus will from time to time be furnished by the Fund, as soon as may be practicably done after the determinations thereof, through brokers' private wires to various newspapers. If it is not convenient for you to obtain such prices from either such brokers or newspapers, we will, at your request, arrange to have you receive from some source these daily quotations.

From time to time, if and to the extent permitted by law, reductions from the regular retail offering price may be allowed in cases of volume investments; but, if so, such fact and the method of determining the public offering price in such cases will be set forth in the Prospectus.

You agree not to purchase as principal or to participate as broker in the purchase of shares except from us, from the Fund, or from investors, and to pay a price not lower

than the bid price then quoted by or for the Fund, and agree not to sell as principal or to participate as broker in the sale of any shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us or the Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

Ordering of Shares:

All sales to you will be made by us, as principal, and such shares are to be resold by you, as principal, to your investor.

Orders and confirmations should be sent direct to Fidelity Fund, Inc., 35 Congress Street, Boston, Massachusetts. The Fund has been authorized to send you confirmation of orders accepted. Shares will be confirmed at the retail offering price in effect when your order is received less the dealer's discount plus expenses, if any, as outlined herein below.

Orders should be communicated as quickly as possible and confirmed by letter.

For orders placed with the principal underwriter between 4 P.M. (except Saturday) and 1 P.M. the next business day, the price of the shares of Fidelity Fund, Inc. will be based upon a calculation of the net asset value on each business day as of the close of the New York Stock Exchange (currently, 3 P.M. week days; 12 NOON Saturdays).

For orders placed with the principal underwriter from 1 P.M. to 4 P.M. on each business day, except Saturday, the offering price of the shares will be calculated so as to reflect at or about 12 NOON on that day any change in the net asset value of the Fund.

For orders placed with the principal underwriter from 1 P.M. Saturday to 1 P.M. on the next following business day, the offering price of the shares will be based upon the calculation of the net asset value as of the close of the market on that Saturday.

For these purposes a business day shall be a day on which the New York Stock Exchange is open for trading. All time shall be New York City time.

You agree that you will not withhold placing a customer's orders in such manner as to profit yourself as a result of such withholding. We, as Underwriter, will not purchase any shares except for the purpose of covering purchase orders already received, and then only at not less than the net asset value upon which the public offering price of such purchase orders is based; and you further agree that you will not purchase shares from us, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder.

We, as Underwriter, will not accept a conditional order for the shares on any basis other than at a specified definite price.

Dealer Discount:

You will receive a discount of six and one-quarter per cent (6.25%) of the regular public offering price (without taking into consideration reductions, if any, in cases of volume investments) on all shares purchased by you from us on and after June 1, 1941.

In the case of a single investment of $25,000 or more the distributing cost to the investor and the dealer's discount will be reduced to conform with the following schedule (the percentage in each case being a percentage of the applicable offering price): namely,

		Cost to Investor	Dealer's Discount
On investments of	$25,000 to $50,000	5%	4.30%
On investments over	50,000 to 75,000	4%	3.45%
On investments over	75,000 to 100,000	3%	2.55%
On investments over	100,000	2%	1.70%

If any shares are repurchased by the Fund, or by us for the account of the Fund, or are tendered for redemption within seven (7) business days (Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable therafter pay to the Fund the full amount of

the "distributing cost" on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us, as the Underwriter, or to the Fund.

Payment and Delivery:

Shares will be delivered to your order against payment in New York or Boston funds for the confirmed price less your discount plus expenses, if any, as stated in the following paragraph. Payment, by certified or cashier's check accompanying order, should be made payable to THE NATIONAL SHAWMUT BANK OF BOSTON, which bank is the Custodian and Transfer Agent for the Fund.

The Fund has arranged with The National Shawmut Bank of Boston for delivery of certificates, sight draft attached, in the stockholder's name, at your option. A power of attorney from your customer for certificates so delivered (such power to be retained by you) will make the certificate negotiable on receipt at your bank.

Collection and insurance expenses in connection with shipping certificates sight draft attached will be borne by you. In the event that you request certificates shipped sight draft attached in the name of your customer, the cost of Federal and Massachusetts State Stamp Taxes (in addition to collection and insurance expenses) will be borne by you and will be a part of the draft charges. When payment is made by an uncertified check, we or the Fund reserve the right to delay transfer until check has cleared.

Use of Prospectus—Federal Laws:

All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

Copies of the Prospectus and of the latest quarterly report issued will be supplied in reasonable quantities upon request. Copies of the "Approved List," which must be furnished to customers in compliance with so called "Blue

Sky Acts" (or Regulations issued thereunder) of certain states, will be likewise furnished upon request.

Pursuant to subdivision 9 of Section 359-e of the New York General Business Law, the undersigned, as Underwriters, agree to cause to be filed a further State Notice respecting the shares in the form required by subdivision 8 of said Section 359-e.

Miscellaneous:

We reserve the right, in our discretion, to reject in whole or in part any order received by us from you, and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action.

This Agreement shall be in substitution for any prior Selling Group Agreement between us regarding shares of Fidelity Fund, Inc.

This Agreement shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of the Fund or of this firm, and you are not authorized to act for us or the Fund or to make any representations on our or its behalf. This Agreement shall survive any changes or successions of the present firm of Paul H. Davis & Co. We shall not be liable in any way or for any matter connected herewith, except for lack of good faith.

Very truly yours,
Paul H. Davis & Co.

12341

Paul H. Davis & Co.
10 South LaSalle Street,
Chicago, Illinois.

Dear Sirs:

We acknowledge receipt of the Sales Agreement regarding shares of Fidelity Fund, Inc., and hereby accept it and agree to be bound by its terms.

When shares are ordered shipped draft attached, please deliver for our account to:

____________________ Bank, ____________________

Please ship us ________ Prospectuses; also ship us ________ copies of latest quarterly report and ________ copies of "Approved List."

We would like to have bulletins, sales literature, etc. as issued, addressed to the following executive of our firm: (Name) ________________ (Title) ________________

We also hereby acknowledge receipt of Prospectus covering the shares and in making any purchases will not rely on statements made by you or your representatives, but on our own knowledge and judgment or on information in said Prospectus.

We hereby certify that we are a member of the National Association of Securities Dealers, Inc.

Firm Name ________________
By ________________________
Street Adress ______________
City ________ State ________

Dated ________, 194__.
12339

EXHIBIT C

THE CROSBY CORPORATION
35 Congress Street
Boston 9, Massachusetts

CApitol 7-7543
CApitol 7-6311

General Distributor of
Fidelity Fund, Inc.
Puritan Fund, Inc.

FIDELITY FUND, INC.
SALES AGREEMENT

October 1, 1948

Dear Sirs:

We, as a General Distributor of the shares of Fidelity Fund, Inc., agree to sell you shares of the Fund upon the following terms:

Retail Price and Bid Price

The bid and regular public offering price of the shares determined as set forth in the Prospectus will from time to time be furnished by the Fund, as soon as may be practicably done after the determinations thereof, through brokers' private wires to various newspapers. If it is not convenient for you to obtain such prices from either such brokers or newspapers, we will, at your request, arrange to have you receive from some source these daily quotations.

From time to time, if and to the extent permitted by law, reductions from the regular retail offering price may be allowed in cases of volume investments; but, if so, such fact and the method of determining the public offering price in such cases will be set forth in the Prospectus.

You agree not to purchase as principal or to participate as broker in the purchase of shares except from us, from the Fund, or from investors, and to pay a price not lower than the bid price then quoted by or for the Fund, and agree not to sell as principal or to participate as broker in the sale of any shares except at a price to the purchaser equal to the applicable offering price (determined as set forth in the Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us or the Fund at the bid price cur-

rently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

Ordering of Shares:

All sales to you will be made by us, as principal, and such shares are to be resold by you, as principal, to your investor.

Orders and confirmations should be sent direct to Fidelity Fund, Inc., 35 Congress Street, Boston 9, Massachusetts. The Fund has been authorized to send you confirmation of orders accepted. Shares will be confirmed at the retail offering price in effect when your order is received less the dealer's discount plus expenses, if any, as outlined herein below.

For orders placed with us between 4 P.M. (except Saturday) and 1 P.M. the next business day, the price of the shares of Fidelity Fund, Inc. will be based upon a calculation of the net asset value on each business day as of the close of the New York Stock Exchange (currently, 3 P.M. weekdays: 12 NOON Saturdays). For orders placed with us from 1 P.M. to 4 P.M. on each business day, except Saturday, the offering price of the charges will be calculated so as to reflect at or about 12 NOON on that day any change in the net asset value of the Fund. For orders placed with us from 1 P.M. Saturday to 1 P.M. on the next following business day, the offering price of the shares will be based upon the calculation of the net asset value as of the close of the market on that Saturday. All time shall be New York City time.

You agree that you will not withhold placing a customer's orders in such manner as to profit yourself as a result of such withholding. We, as a Distributor, will not purchase any shares except for the purpose of covering purchase orders already received, and then only at not less than the net asset value upon which the public offering price of such purchase orders is based; and you further agree that you will not purchase shares from us, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder.

We, as a Distributor, will not accept a conditional offer for the shares on any basis other than at a specified definite price.

Dealer Discount:

You will receive a discount of six percent (6%) of the regular public offering price (except in cases of volume investments) on all shares by you from us.

In the case of a single investment of $25,000 or more the sales load to the investor will be reduced to conform to the following schedule (the percentage in each case being a percentage of the applicable offering price):

			Cost to Investor	Dealer's Discount
On investments of	$ 25,000 to $ 50,000	....	5%	4.0%
On investments of	50,000 to 100,000	....	4%	3.2%
On investments of	100,000 to 200,000	....	3%	2.4%
On investments over	200,000	....	2%	1.6%

The benefit of the lower public offering prices set out above is available also to an individual or corporate trustee, guardian or other fiduciary in respect of his fiduciary accounts (including accounts in which he has co-fiduciaries) if his aggregate fiduciary purchases, made at a single time from a single dealer, total $25,000 or more

February 23, 1950

If any shares are repurchased by the fund or by us for the account of the Fund, or are tendered for redemption within seven (7) business days (Sundays and holidays not being considered business days) for confirmation to you of the original purchase order for such shares, you shall forthwith refund to us the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the "distributing cost" on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us, as a Distributor, or to the Fund.

Payment and Delivery:

Upon receipt of written confirmation from Fidelity Fund, Inc., you should make payment for the net amount shown on their invoice. Your transfer instructions should be given in the space provided (in the lower part) of the Fund's invoice.

Payment by certified or cashier's check, in New York or Boston funds, should be made payable to THE NATIONAL SHAWMUT BANK OF BOSTON, which bank is the Custodian and Transfer Agent for the Fund. When payment is made by uncertified check, the Bank or the Fund reserves the right to delay transfer until the check is cleared. The Bank requires with your transfer instructions Fidelity Fund's invoice number which is given at the top right hand corner of the Fund's invoice to you, thus identifying the particular transaction.

Use of Prospectus—Federal Laws:

All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1935, as amended, the Securities Exchange Act of 1954, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

Copies of the Prospectus and of the latest quarterly report issued will be supplied in reasonable quantities upon request.

Miscellaneous:

We reserve the right, in our discretion, to reject in whole or in part any order received by us from you, and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of Fidelity Fund, Inc. and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of the Fund or of this firm, and you are not authorized to act for us or the Fund or to make any representations on our or its behalf. This Agreement shall survive any changes or successions of the present firm of The Crosby Corpora-

tion. We shall not be liable in any way or for any matter connected herewith, except for lack of good faith.

Very truly yours,
THE CROSBY CORPORATION

We acknowledge receipt of the Sales Agreement regarding shares of Fidelity Fund, Inc., and hereby accept it and agree to be bound by its terms.

Kindly ship to us

..............Prospectus
..............Most recent financial statement
..............Other literature
addressed to the following executive of our firm:

We hereby certify that we are members of the National Association of Securities Dealers, Inc., and this agreement shall terminate automatically in the event of our ceasing to be a member in good standing of the N.A.S.D.

Firm Name ....
By ....
Street Address ....
City .... State ....
Dated ...., 194 ......

THE CROSBY CORPORATION
53 State St., Boston 9, Mass.
Telephone CApital 7-6311
Teletype: BS 411

RAYMOND L. MYRER
President

General Distributor
Fidelity Fund, Inc.
Puritan Fund, Inc.
Fidelity Capital Fund, Inc.

FIDELITY FUND, INC. • PURITAN FUND, INC.
FIDELITY CAPITAL FUND, INC.

Sales Agreement

February 2, 1959

Dear Sirs:

We, as agent of Fidelity Fund, Inc., Puritan Fund, Inc. and Fidelity Capital Fund, Inc., agree to sell you shares of these Funds upon the following terms:

Retail Price and Bid Price:

The bid and regular public offering price of the shares, determined as set forth in the applicable Prospectus, will from time to time be furnished by or on behalf of the Funds, as soon as practicable after the determinations thereof, through brokers' private wires to various newspapers. It is not convenient for you to obtain such prices from either such brokers or newspapers, we will, at your request, arrange to have you receive from some source these twice daily quotations during the periods when such shares are continuously offered by the Funds at prices based on their net asset values.

You agree not to purchase as principal or to participate as broker in the purchase of shares except from the Funds or from investors, and to pay a price not lower than the bid price then quoted by or for the Funds. You further agree not to sell as principal or to participate as broker in the sale of any shares except at a price to the purchaser equal to the applicable offering price (determined as set forth in the applicable Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares

for the account of an investor to us or the Fund at the bid price currently quoted by or for the Funds and charging the investor a fair commission for handling the transaction.

Ordering of Shares:

All sales to you will be made through us as agent, and such shares are to be resold by you, as principal, to your investor.

Orders and confirmation should be sent direct to Fidelity Fund, Inc., to Puritan Fund, Inc. or to Fidelity Capital Fund, Inc., 35 Congress Street, Boston 9 Massachusetts. The Funds will send you confirmation of orders accepted. Shares will be confirmed at the retail offering price in effect when your order is received less the dealer's discount plus expenses, if any, as outlined below.

For orders placed with us between 4:30 P.M. and 2 P.M. the next business day, the price of the shares of the Funds will be based upon a calculation of the net asset value on each business day as of the close of the New York Stock Exchange (currently, 3:30 P.M.). For orders placed with us from 2 P.M. to 4:30 P.M. on each business day, the offering price of the shares will be calculated so as to reflect at or about 1:00 P.M. on that day any change in the net asset value of the Funds. All time shall be New York City time. The price of shares of Fidelity Capital Fund, Inc. during the initial offering of such shares shall be fixed as set forth below and the price of such shares purchased during the Future Continuous Offering of them which is expected to begin on March 2, 1959 shall be determined as described in the preceding three sentences.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares through us, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder.

We, as a Distributor, will not accept a conditional offer for the shares on any basis other than at a specified definite price. Shares of Fidelity Capital Fund, Inc. may be offered and sold during the initial offering only on a "when, as and if issued" basis, and offers to buy such shares will be accepted by us only upon that basis.

Dealer Discount and Sales Charge:

The sales charges and discounts allowed to dealers on shares purchased through us during continuous offerings are as follows (the percentage in each case being a percentage of the applicable offering price):

	At least	But less than	Fidelity Fund, Inc. Puritan Fund, Inc. Sales Charge Paid by Investor	Fidelity Fund, Inc. Puritan Fund, Inc. Dealer Discount	Fidelity Capital Fund, Inc. Sales Charge Paid by Investor	Fidelity Capital Fund, Inc. Dealer Discount
On investments of	(10 shares)	$ 25,000	7.5%	6.0%	8.0%	6.5%
On investments of	$ 25,000 ...	50,000	5.0%	4.0%	5.5%	4.5%
On investments of	50,000 ...	100,000	4.0%	3.2%	4.5%	3.5%
On investments of	100,000 ...	200,000	3.0%	2.4%	3.0%	2.0%
On investments of	200,000 ...	500,000	2.0%	1.6%	2.0%	1.0%
On investments over	500,000 ...		1.0%	.8%	2.0%	1.0%

In the case of Continuous Investment and Dividend Reinvestment Plans, no commission will be paid to the dealer on any transaction for which the dealer's net sales commission is less than $1.

During the initial offering of shares of Fidelity Capital Fund, Inc. the price to dealers and the price to the public shall be as follows:

At least	But less than	Price to Dealers	Price to Public
(10 shares)	$ 25,000	$11.16	$12.00
$ 25,000	50,000	11.16	11.68
50,000	100,000	11.16	11.56
100,000	200,000	11.16	11.38
200,000		11.16	11.27

The benefit of the lower public offering prices set out above is available also to an individual purchasing for himself, his spouse and their children under the age of twenty-one, and to an individual or corporate trustee, guardian or other like fiduciary purchasing securities for a single trust estate or single fiduciary account (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) if the aggregate purchase in a single transaction totals $25,000 or more.

In addition, any of the persons enumerated above may

sign a statement of intention in the form provided by the underwriter covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales commission applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the "distributing cost" on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10 days of the date on which the certificate is delivered to us, as a Distributor, or to the Fund.

Payment and Delivery:

A detailed statement confirming your purchase of shares of the Fund will be forwarded to you. Upon receipt of such statement you will make payment for the net amount shown thereon, including transfer taxes covering sale by you as principal to your customer.

Payment, by certified or cashier's check in New York or Boston funds, should be made payable to THE NATIONAL SHAWMUT BANK OF BOSTON, which bank is the Custodian and Transfer Agent for each of the Funds. When payment is made by uncertified check, the Bank or the Funds reserve the right to delay transfer until the check is cleared. *It is not the procedure or policy of any of the Funds or of the Distributor to send capital stock draft-attached to selling group members.*

All transfer instructions filed by you must refer to THE INVOICE NUMBER SHOWN ON THE STATEMENT SENT YOU. This will minimize errors and identify the particular transaction.

In the case of sales of shares of Fidelity Capital Fund, Inc. during the initial offering, payment, by certified or cashier's check in New York or Boston funds, accompanied

by instructions as to the names and denominations of certificates, must be made to The National Shawmut Bank of Boston on or before the call date to be fixed by us of which we shall give you 5 days' notice. Confirmations of such sales shall be sent to you as soon as practicable after such shares are issued, and payment therefore made to the Fund.

Use of Prospectus—Federal Laws:

All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

Upon request copies of the respective Prospectuses and most recent financial statement issued will be supplied in reasonable quantities.

Miscellaneous:

We reserve the right to amend this agreement and, in our discretion, to reject in whole or in part any order received by us from you, and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this firm, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except for lack of good faith.

Very truly yours,
THE CROSBY CORPORATION
By ....

We acknowledge receipt of the Sales Agreement regarding shares of Fidelity Fund, Inc., Puritan Fund, Inc. and Fidelity Capital Fund, Inc., and hereby accept it and agree to be bound by its terms.

We hereby certify that we are members of the National Association of Securities Dealers, Inc., and this Agreement shall terminate automatically in the event of our ceasing to be a member in good standing of the N.A.S.D.

Firm Name ....

By ....

Street Address ....

City .... State ....

Dated ...., 195....

THE CROSBY CORPORATION
53 State St., Boston 9, Mass.
Telephone LAfayette 3-7600
CApitol 7-4304
General Distributor

FIDELITY FUND, INC. FIDELITY TREND FUND, INC.
PURITAN FUND, INC. FIDELITY CAPITAL FUND, INC.

Sales Agreement

January 2, 1962

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from customers. All orders should be sent directly to the proper Fund at 35 Congress Street, Boston 9, Massachusetts which will accept and confirm such orders to you at the applicable public offering price described in the Fund's currently effective prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased through us are as follows (the percentage in each case being a percentage of the applicable public offering price):

			Fidelity Fund, Inc. Puritan Fund, Inc.		Fidelity Capital Fund, Inc. Fidelity Trend Fund, Inc.	
	At least	But less than	Sales Charge Paid by Investor	Dealer Discount	Sales Charge Paid by Investor	Dealer Discount
On investments of	(see Notes)	$ 25,000	7.5%	6.0%	8.0%	6.0%
On investments of	$ 25,000 ..	50,000	5.0%	4.0%	5.0%	4.0%
On investments of	50,000 ..	100,000	4.0%	3.2%	4.0%	3.2%
On investments of	100,000 ..	200,000	3.0%	2.4%	3.0%	2.4%
On investments of	200,000 ..	500,000	2.0%	1.6%	2.0%	1.6%
On investments over	500,000 ..		1.0%	.8%	1.0%	.8%

Notes: The minimum initial investment in shares of Fidelity Fund, Inc., Fidelity Capital Fund, Inc. and Fidelity Trend Fund, Inc. must be ten (10) shares. *The minimum initial investment in shares of Puritan Fund, Inc. must be twenty (20) shares.*
In the case of Continuous Investment and Dividend Reinvestment Plans, no commission will be paid to the dealer unless the net commission after taxes on any single transaction amounts to at least $1.

The above scale is applicable to purchases made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purchase of shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales commission applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of our confirmation you will pay promptly the net amounts due as shown thereon including transfer taxes due on sale by you as principal to your customer. Payment should be made by certified or cashier's check in New York or Boston funds as follows:

Fund	Custodian and Transfer Agent to whom checks should be made payable
Fidelity Fund, Inc. Puritan Fund, Inc. Fidelity Capital Fund, Inc.	The National Shawmut Bank of Boston 40 Water Street Boston, Massachusetts
Fidelity Trend Fund, Inc.	State Street Bank and Trust Company State and Congress Streets Boston, Massachusetts

ALL TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION FOR IDENTIFICATION PURPOSES. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100.

Other Transactions in Fund Shares

You agreed not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except from the Funds or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares through us, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you, and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,

THE CROSBY CORPORATION

By ....

Accepted: 196

....
Firm Name

By ....
Authorized Officer or Partner

....
Street Address

....
City State

SALES AGREEMENT

The Crosby Corporation, General Distributor	Fidelity Fund, Inc.
225 Franklin Street, Boston, Mass. 02210	Fidelity Bond-Debenture Fund, Inc.
Executive Offices— 617-423-6150	Fidelity-Capital Fund, Inc.
Teletype 710-321-1209	Fidelity Trend Fund, Inc.
Order Department— 617-742-5700	Puritan Fund, Inc.
Cable—Crosfidel	Essex Fund, Inc.
	Contrafund, Inc.
	Salem Fund, Inc.
	Everest Fund, Inc.

November 1, 1971

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price described in the applicable Fund's then currently effective Prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Sales Charge Paid by Investor	Dealer Discount (2)
On investments of ..	Note (1)	$ 10,000	8.5%	7.0%
On investments of ..	$ 10,000	25,000	8.0%	6.5%
On investments of ..	25,000	50,000	6.0%	4.8%
On investments of ..	50,000	100,000	4.5%	3.6%
On investments of ..	100,000	250,000	3.5%	2.8%
On investments of ..	250,000	500,000	2.5%	2.0%
On investments of ..	500,000	1,000,000	2.0%	1.6%
On investments over	1,000,000		1.0%	0.8%

Notes: (1) The minimum initial and subsequent investments must be as specified in the then currently effective applicable Fund Prospectus.

(2) In the case of dividends reinvested on Voluntary Accumulation Plans or under an open account, the dealer discount on any single dividend reinvestment transaction will be paid only if it amounts to at least $5.00.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the then currently effective applicable Fund Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, as amended, and the Rules and Regulations thereunder, and any applicable rules

of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the then currently effective applicable Fund Prospectus and in such other printed information as may be subsequently issued by us as information supplemental to such Prospectus or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Salem Fund, Inc.," "Everest Fund, Inc.," "Essex Fund, Inc.," "Contrafund, Inc.," "Fidelity Bond-Debenture Fund, Inc.," or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

The terms and conditions of this Agreement shall apply to the limited public offerings of the shares of Essex Fund, Inc. and Contrafund, Inc. so long as their shares are being publicly offered, except that there are no Voluntary Accumulation Plans offered in connection with such Funds. This Agreement shall terminate as to each of such Funds without the necessity of notice to you upon the termination of its respective limited public offering.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

This Agreement supersedes and cancels any prior agreement with respect to the sale of shares of any of the Funds for which we are the principal underwriter and we reserve the right to amend this Agreement at any time and from time to time or to terminate the same at any time.

We and/or the Funds in the Fidelity Group of Funds may at any time modify the sale charge and dealer discount to be paid in connection with the sale of shares of any of those Funds. In the event of any such change you agree that you will have no continuing claim to or vested interest in the level of sales charges or dealer discounts established by

this Agreement as to any shares purchased subsequent to such change.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,

THE CROSBY CORPORATION

....

Dated As Of ...., 1971 Firm ....

By ....

Authorized Signature

Address ....

SALES AGREEMENT

The Crosby Corporation,
General Distributor
225 Franklin Street,
Boston, Mass. 02110
Executive Offices—
617-423-6150
Teletype 710-321-1209
Order Department—617-742-5700
Cable-Crosfidel

Fidelity Fund, Inc.
Fidelity Capital Fund, Inc.
Fidelity Trend Fund, Inc.
Puritan Fund, Inc.
Salem Fund, Inc.
Everest Fund, Inc.

July 1, 1970

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price described in the Fund's currently effective Prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Sales Charge Paid by Investor	Dealer Discount
On investments of	(10 shares)	$ 10,000	8.5%	7.0%
On investments of	$ 10,000	25,000	8.0%	6.5%
On investments of	25,000	50,000	6.0%	4.8%
On investments of	50,000	100,000	4.5%	3.6%
On investments of	100,000	250,000	3.5%	2.8%
On investments of	250,000	500,000	2.5%	2.0%
On investments of	500,000	1,000,000	2.0%	1.6%
On investment over	1,000,000		1.0%	0.8%

Notes: The minimum initial investment must be ten (10) shares.
In the case of dividends reinvested on Voluntary Accumulation Plans, the dealer discount on any single dividend reinvestment transaction will be paid only if it amounts to at least $5.00.

Purchases of shares of one or more of the above Funds, made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved, may be aggregated for purposes of determining the respective sales charges applicable to the shares so purchased; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales charge applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made

by certified or cashier's check in New York or Boston funds to:

The Crosby Corporation
Cash Clearing Department, 3rd Floor
10 Post Office Square
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100. WE RESERVE THE RIGHT TO HOLD YOU RESPONSIBLE FOR ANY LOSS WE MAY INCUR AS THE RESULT OF YOUR FAILURE TO MAKE ANY SUCH PAYMENTS.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders

were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the current Fund Prospectuses and in such other printed information as may be subsequently issued by us as information supplemental to such Fund Prospectuses or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Salem Fund, Inc.," "Everest Fund, Inc." or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected here-

with, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space p: ovided below.

Very truly yours,
THE CROSBY CORPORATION

____

Dated As Of __________ _____, 19__.

Firm ____________________________

By ____________________________

Authorized Signature

Address ____________________________

____

SALES AGREEMENT

The Crosby Corporation,
General Distributor
225 Franklin Street.
Boston, Mass. 02110
Executive Offices—
617-423-6150
Teletype 710-321-1209
Order Department—
617-742-5700
Cable-Crosfidel

Fidelity Fund, Inc.
Fidelity Capital Fund, Inc.
Fidelity Trend Fund, Inc.
Puritan Fund, Inc.
Salem Fund, Inc.
Everest Fund, Inc.

November 12, 1969

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders, to you at the applicable public offering price described in the Fund's currently effective Prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Sales Charge Paid by Investor	Dealer Discount
On investments of	(10 shares)	$ 10,000	8.5%	7.0%
On investments of	$ 10,000	25,000	8.0%	6.5%
On investments of	25,000	50,000	6.0%	4.8%
On investments of	50,000	100,000	4.5%	3.6%
On investments of	100,000	250,000	3.5%	2.8%
On investments of	250,000	500,000	2.5%	2.0%
On investments of	500,000	1,000,000	2.0%	1.6%
on investments over	1,000,000		1.0%	0.8%

Notes: The minimum initial investment must be ten (10) shares.
In the case of Voluntary Accumulation Plans, no commission will be paid to the dealer unless the net commission on any single transaction amounts to at least $1.

Purchases of shares of one or more of the above Funds, made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved, may be aggregated for purposes of determining the respective sales charges applicable to the shares so purchased; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales charge applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made

by certified or cashier's check in New York or Boston funds to:

The Crosby Corporation
Cash Clearing Department, 3rd Floor
10 Post Office Square
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100. WE RESERVE THE RIGHT TO HOLD YOU RESPONSIBLE FOR ANY LOSS WE MAY INCUR AS THE RESULT OF YOUR FAILURE TO MAKE ANY SUCH PAYMENTS.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders

were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the current Fund Prospectuses and in such other printed information as may be subsequently issued by us as information supplemental to such Fund Prospectuses or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Salem Fund, Inc.," "Everest Fund, Inc." or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected here-

with, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,
THE CROSBY CORPORATION

____

Dated As Of ____________, 19__.

Firm ______________________________
By ______________________________
Authorized Signature
Address ______________________________
____

THE CROSBY CORPORATION

225 Franklin Street • Boston • Mass. • 02110
• Area Code 617-423-6150

Order Department-742-5700 • Teletype 710-321-1209
• Cable-Crosfidel

Fidelity Fund, Inc.
Puritan Fund, Inc.
Fidelity Capital Fund, Inc.
Everest Fund, Inc.
Dow Theory Investment Fund, Inc.
Fidelity Trend Fund, Inc.

Dear Sirs: *Sales Agreement* May 1, 1969

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price described in the Fund's currently effective prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

			Fidelity Fund, Inc. Puritan Fund, Inc. Everest Fund, Inc.		Fidelity Trend Fund, Inc. Fidelity Capital Fund, Inc. Dow Theory Investment Fund, Inc.	
	At least	But less than	Sales Charge Paid by Investor	Dealer Discount	Sales Charge Paid by Investor	Dealer Discount
On investments of	(see Notes) ..	$ 10,000	7.5%	6.0%	8.5%	7.0%
On investments of	$ 10,000 ..	25,000	7.5%	6.0%	8.0%	6.5%
On investments of	25,000 ..	50,000	5.0%	4.0%	6.0%	4.8%
On investments of	50,000 ..	100,000	4.0%	3.2%	4.5%	3.6%
On investments of	100,000 ..	250,000	3.0%	2.4%	3.5%	2.8%
On investments of	250,000 ..	500,000	2.5%	2.0%	2.5%	2.0%
On investments of	500,000 ..	1,000,000	2.0%	1.6%	2.0%	1.6%
On investments over	1,000,000 ..		1.0%	0.8%	1.0%	0.8%

Notes: The minimum initial investment must be ten (10) shares.
In the case of Voluntary Accumulation Plans, in commission will be paid to the dealer unless the net commission on any single transaction amounts to at least $1.

Purchases of shares of one or more of the above Funds, made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved, may be aggregated for purposes of determining the respective sales charges applicable to the shares so purchased; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales charge applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made

by certified or cashier's check in New York or Boston funds to:

The Crosby Corporation
Cash Clearing Department, 2nd Floor
68 Devonshire Street
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100. WE RESERVE THE RIGHT TO HOLD YOU RESPONSIBLE FOR ANY LOSS WE MAY INCUR AS THE RESULT OF YOUR FAILURE TO MAKE ANY SUCH PAYMENTS.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders

were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the current Fund Prospectuses and in such other printed information as may be subsequently issued by us as information supplemental to such Fund Prospectuses or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Dow Theory Investment Fund, Inc.," "Everest Fund, Inc." or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith,

except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,
THE CROSBY CORPORATION

____

Dated As Of ____________, 19__.

Firm ______________________________

By ______________________________
Authorized Signature

Address ______________________________

____

THE CROSBY CORPORATION

225 Franklin Street • Boston • Mass. • 02110
• Area Code 617-423-6150

Order Department-742-5700 • Teletype 710-321-1209
• Cable-Crosfidel

Fidelity Fund, Inc.
Puritan Fund, Inc.
Fidelity Capital Fund, Inc.
Fidelity Trend Fund, Inc.
Dow Theory Investment Fund, Inc.
Everest Income Fund, Inc.

Dear Sirs: *Sales Agreement* November 27, 1967

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price described in the Fund's currently effective prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Fidelity Fund, Inc. Puritan Fund, Inc. Dow Theory Investment, Fund, Inc. Everest Income Fund, Inc. — Sales Charge Paid by Investor	Dealer Discount	Fidelity Trend Fund, Inc. Fidelity Capital Fund, Inc. — Sales Charge Paid by Investor	Dealer Discount
On investments of	(see Notes) ..	$ 25,000	7.5%	6.0%	8.0%	6.0%
On investments of	$ 25,000 ..	50,000	5.0%	4.0%	5.0%	4.0%
On investments of	50,000 ..	100,000	4.0%	3.2%	4.0%	3.2%
On investments of	100,000 ..	250,000	3.0%	2.4%	3.0%	2.4%
On investments of	250,000 ..	500,000	2.5%	2.0%	2.5%	2.0%
On investments of	500,000 ..	1,000,000	2.0%	1.6%	2.0%	1.6%
On investments over	1,000,000 ..		1.0%	.8%	1.0%	.8%

Notes: The minimum initial investment must be ten (10) shares.

In the case of Continuous Investment and Dividend Reinvestment Plans, no commission will be paid to the dealer unless the net commission on any single transaction amounts to at least $1.

The above scale is applicable to purchases made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales commission applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made by certified or cashier's check in New York or Boston funds to:

The Crosby Corporation
Cash Clearing Department, 5th Floor
31 Milk Street
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree than you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the current Fund Prospectuses and in such other printed information as may be subsequently issued by us as information supplemental to such Fund Prospectuses or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Dow Theory Investment Fund, Inc.," "Everest Income Fund, Inc." or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,
THE CROSBY CORPORATION

____

Dated As Of __________, 19__.

Firm ____________________________

By ____________________________

Authorized Signature

Address ____________________________

____

THE CROSBY CORPORATION

225 Franklin Street • Boston • Mass. • 02110
• Area Code 617-423-6150

Order Department-742-5700 • Teletype 710-321-1209
• Cable-Crosfidel

Fidelity Fund, Inc. Puritan Fund, Inc.
Fidelity Capital Fund, Inc. Fidelity Trend Fund, Inc.
Dow Theory Investment Fund, Inc.
Everest Income Fund, Inc.

Dear Sirs: *Sales Agreement* June 12, 1967

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price described in the Fund's currently effective prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

			Fidelity Fund, Inc. Puritan Fund, Inc. Dow Theory Investment, Fund, Inc. Everest Income Fund, Inc.		Fidelity Trend Fund, Inc. Fidelity Capital Fund, Inc.	
	At least	But less than	Sales Charge Paid by Investor	Dealer Discount	Sales Charge Paid by Investor	Dealer Discount
On investments of	(see Notes) ..	$ 25,000	7.5%	6.0%	8.0%	6.0%
On investments of	$ 25,000 ..	50,000	5.0%	4.0%	5.0%	4.0%
On investments of	50,000 ..	100,000	4.0%	3.2%	4.0%	3.2%
On investments of	100,000 ..	250,000	3.0%	2.4%	3.0%	2.4%
On investments of	250,000 ..	500,000	2.5%	2.0%	2.5%	2.0%
On investments of	500,000 ..	1,000,000	2.0%	1.6%	2.0%	1.6%
On investments over	1,000,000 ..		1.0%	.8%	1.0%	.8%

Notes: The minimum initial investment must be ten (10) shares.
In the case of Continuous Investment and Dividend Reinvestment Plans, no commission will be paid to the dealer unless the net commission on any single transaction amounts to at least $1.

The above scale is applicable to purchases made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales commission applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amounts due as shown thereon. Payment should be made by certified or cashier's check in New York or Boston funds as follows:

Fund	Clearance Agent to whom checks should be made payable
Fidelity Fund, Inc. Puritan Fund, Inc. Fidelity Capital Fund, Inc. Dow Theory Investment Fund, Inc.	The Crosby Corporation Cash Clearing Department, 5th Floor 31 Milk Street Boston, Massachusetts 02109
Fidelity Trend Fund, Inc. Everest Income Fund, Inc.	State Street Bank and Trust Company Clearance Unit P.O. Box 2357 Boston, Massachusetts 02107

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling any shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of

such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representations concerning the Funds other than those which are contained in the current Fund Prospectuses and in such other printed information as may be subsequently issued by us as information supplemental to such Fund Prospectuses or approved by us in writing for use in connection therewith. You will not use words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund, Inc.," "Dow Theory Investment Fund, Inc.," "Everest Income Fund, Inc." or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner

of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,
THE CROSBY CORPORATION

____

Dated As Of ____________, 19__.

Firm ________________________

By ________________________
Authorized Signature

Address ________________________

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THE CROSBY CORPORATION
31 Milk Street • Boston 9 • Massachusetts • Liberty 2-5777
Order Department • Lafayette 3-7600
Teletype • 617-451-3970 • Cable-Crosfidel

PURITAN FUND, INC.
FIDELITY FUND, INC. FIDELITY TREND FUND, INC.
FIDELITY CAPITAL FUND, INC.
Dow Theory Investment Fund, Inc.

Dear Sirs: *Sales Agreement* May 1, 1964

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be sent directly to the proper Fund at 35 Congress Street, Boston 9, Massachusetts which will accept and confirm such orders to you at the applicable public offering price described in the Fund's currently effective prospectus, less the Dealer Discount described below and expenses, if any. The bid and public offering prices of the Funds' shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased through us are as follows (the percentage in each case being a percentage of the applicable public offering price):

			Fidelity Fund, Inc. Puritan Fund, Inc. Dow Theory Investment, Fund, Inc.		Fidelity Trend Fund, Inc. Fidelity Capital Fund, Inc.	
	At least	But less than	Sales Charge Paid by Investor	Dealer Discount	Sales Charge Paid by Investor	Dealer Discount
On investments of	(see Notes) ..	$ 25,000	7.5%	6.0%	8.0%	6.0%
On investments of	$ 25,000 ..	50,000	5.0%	4.0%	5.0%	4.0%
On investments of	50,000 ..	100,000	4.0%	3.2%	4.0%	3.2%
On investments of	100,000 ..	250,000	3.0%	2.4%	3.0%	2.4%
On investments of	250,000 ..	500,000	2.5%	2.0%	2.5%	2.0%
On investments of	500,000 ..	1,000,000	2.0%	1.6%	2.0%	1.6%
On investments over	1,000,000 ..		1.0%	.8%	1.0%	.8%

Notes: The minimum initial investment must be ten (10) shares.
In the case of Continuous Investment and Dividend Reinvestment Plans, no commission will be paid to the dealer unless the net commission after taxes on any single transaction amounts to at least $1.

The above scale is applicable to purchases made at one time by "any person," which term shall include an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other fiduciary of a single trust estate or single fiduciary account, (including a pension profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purchase of shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

In addition, any of the persons enumerated above may sign a statement of intention in the form provided by us covering purchases to be made within a period of thirteen months and thereby become eligible for the reduced sales commission applicable to the total amount purchased or to the amount of the specified intended purchase, whichever amount is less, provided such amount is not less than $25,000.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of our confirmation you will pay promptly the net amounts due as shown thereon including any transfer taxes due on sale by you as principal to your customer. Payment should be made by certified or cashier's check in New York or Boston funds as follows:

Fund	Custodian and Transfer Agent to whom checks should be made payable
Fidelity Fund, Inc. Puritan Fund, Inc. Fidelity Capital Fund, Inc.	The National Shawmut Bank of Boston 40 Water Street Boston, Massachusetts
Dow Theory Investment Fund, Inc.	State Street Bank and Trust Company

ALL TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION FOR IDENTIFICATION PURPOSES. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100.

Other Transactions in Fund Shares

You agreed not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except from the Funds or from investors, and to pay a price not lower than the bid price then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the current Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling my shares for the account of an investor to us of the appropriate Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares through us, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you, and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of any of the Funds or of this corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

If the foregoing represents your understanding, please so indicate by signing in the space provided below.

Very truly yours,

THE CROSBY CORPORATION

Firm ....

By ....
Authorized Signature

Address ....

PAUL H. DAVIS & CO.
Established 1916

MEMBERS
PRINCIPAL STOCK EXCHANGES

10 South La Salle Street
Telephone FRanklin 8922
Chicago 3, Ill.

General Distributor of
Fidelity Fund, Inc.
Puritan Fund, Inc.

FIDELITY FUND, INC.
SALES AGREEMENT

May 1, 1947

Dear Sirs:

We, as a General Distributor of the shares of Fidelity Fund, Inc., agree to sell you shares of the Fund upon the following terms:

Retail Price and Bid Price:

The bid and regular public offering price of the shares determined as set forth in the Prospectus will from time to time be furnished by the Fund, as soon as may be practicably done after the determinations thereof, through brokers' private wires to various newspapers. If it is not convenient for you to obtain such prices from either such brokers or newspapers, we will, at your request, arrange to have you receive from some source these daily quotations.

From time to time, if and to the extent permitted by law, reductions from the regular retail offering price may be allowed in cases of volume investments; but, if so, such fact and the method of determining the public offering price in such cases will be set forth in the Prospectus.

You agree not to purchase as principal or to participate as broker in the purchase of shares except from us, from the Fund, or from investors, and to pay a price not lower than the bid price then quoted by or for the Fund, and agree not to sell as principal or to participate as broker in the sale of any shares except at a price to the purchaser equal to the applicable offering price (determined as set forth in the Prospectus) in effect at the time of such sale, unless such sale is to the Fund or to us, provided nothing

in this paragraph shall prevent you from selling any shares for the account of an investor to us or the Fund at the bid price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

Ordering of Shares:

All sales to you will be made by us, as principal, and such shares are to be resold by you, as principal, to your investor.

Orders and confirmations should be sent direct to Fidelity Fund, Inc., 35 Congress Street, Boston 9, Massachusetts. The Fund has been authorized to send you confirmation of orders accepted. Shares will be confirmed at the retail offering price in effect when your order is received less the dealer's discount plus expenses, if any, as outlined herein below.

For orders placed with us between 4 P.M. (except Saturday) and 1 P.M. the next business day, the price of the shares of Fidelity Fund, Inc. will be based upon a calculation of the net asset value on each business day as of the close of the New York Stock Exchange (currently, 5 P.M. weekdays; 12 NOON Saturdays). For orders placed with us from 1 P.M. to 4 P.M. on each business day, except Saturday, the offering price of the shares will be calculated so as to reflect at or about 12 NOON on that day any change in the net asset value of the Fund. For orders placed with us from 1 P.M. Saturday to 1 P.M. on the next following business day, the offering price of the shares will be based upon the calculation of the net asset value as of the close of the market on that Saturday. All time shall be New York City time.

You agree that you will not withhold placing a customer's orders in such manner as to profit yourself as a result of such withholding. We, as a Distributor, will not purchase any shares except for the purpose of covering purchase orders already received, and then only at not less than the net asset value upon which the public offering price of such purchase orders is based; and you further agree that you will not purchase shares from us, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the commission or discount allowed hereunder.

We, as a Distributor, will not accept a conditional offer for the shares on any basis other than at a specified definite price.

Dealer Discount:

You will receive a discount of six per cent (6%) of the regular public offering price (except in cases of volume investments) on all shares purchased by you from us.

In the case of a single investment of $50,000 or more—or a group of investors whose securities at the time of such investment are supervised by a single individual, agent, trustee, or registered investment adviser—the distributing cost to the investor and the dealer's discount will be reduced to conform with the following schedule (the percentage in each case being a percentage of the applicable offering price); namely,

	Cost to Invester	Dealer's Discount
On investments of $50,000 to $100,000.	5%	4.0%
On investments of $100,000 to $200,000	3%	2.4%
On investments over $200,000........	2%	1.6%

If any shares are repurchased by the Fund, or by us for the account of the Fund, or are tendered for redemption within seven (7) business days (Sundays and holidays not being considered business days) after confirmation to you of the original purchase order for such shares, you shall forthwith refund to us the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the Fund the full amount of the "distributing cost" on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us, as a Distributor, or to the Fund.

Payment and Delivery:

Upon receipt of written confirmation from Fidelity Fund, Inc., you should make payment for the net amount shown on their invoice. Your transfer instructions should be given in the space provided (in the lower part) of the Fund's invoice.

Payment, by certified or cashier's check, in New York or Boston funds, should be made payable to THE NATIONAL SHAWMUT BANK OF BOSTON, which bank is the Custodian and Transfer Agent for the Fund. When payment is made by uncertified check, the Bank or the Fund reserves the right to delay transfer until the check is cleared. The Bank requires with your transfer instructions Fidelity Fund's invoice number which is given at the top right hand corner of the Fund's invoice to you, thus identifying the particular transaction.

Use of Prospectus—Federal Laws:

All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1954, as amended, the Investment Company Act of 1940, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

Copies of the Prospectus and of the latest quarterly report issued will be supplied in reasonable quantities upon request. Copies of the "Approved List," which must be furnished to customers in compliance with so-called "Blue Sky Acts" (or Regulations issued thereunder) of certain states, will be likewise furnished upon request.

Miscellaneous:

We reserve the right, in our discretion, to reject in whole or in part any order received by us from you, and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of Fidelity Fund, Inc. and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent, representative, or partner of the Fund or of this firm, and you are not authorized to act for us or the Fund or to make any representations on

our or its behalf. This Agreement shall survive any changes or successions of the present firm of Paul H. Davis & Co. We shall not be liable in any way or for any matter connected herewith, except for lack of good faith.

Very truly yours,
PAUL H. DAVIS & CO.

We acknowledge receipt of the Sales Agreement regarding shares of Fidelity Fund, Inc., and hereby accept it and agree to be bound by its terms.

Kindly ship to us

..........Prospectus
..........Most recent financial statement
..........Other literature
addressed to the following executive of our firm:

We hereby certify that we are members of the National Association of Securities Dealers, Inc., and this agreement shall terminate automatically in the event of our ceasing to be a member in good standing of the N.A.S.D.

Firm Name ....
By ....
Street Address ....
City .... State ....
Dated ...., 194....

EXHIBIT D

Sales Agreement

THE CROSBY CORPORATION
225 Franklin Street • Boston • Mass. • 02110

Executive Offices-617-726-0400 • Cable-Crosfidel
Order Department-617-742-5700 • Teletype 710-321-0211

Fidelity Fund, Inc.
Fidelity Bond-Debenture Fund, Inc.
Fidelity Capital Fund, Inc.

Fidelity Trend Fund, Inc.

Puritan Fund, Inc.
Salem Fund, Inc.
Everest Fund, Inc.

November 1, 1972

Dear Sirs:

We are the principal underwriter of shares of the above Funds which we agree to sell to you to cover orders received by you as principal from your customers. All orders should be communicated directly to The Crosby Corporation which will accept and confirm such orders to you at the applicable public offering price computed as described in the applicable Fund's then currently effective Prospectus, less the Dealer Discount described below. The net asset value and public offering prices of the Fund's shares will be furnished from time to time to public information sources.

Sales Charge and Dealer Discount

The sales charges and discounts allowed to dealers on shares purchased are as follows (the percentage in each case being a percentage of the applicable public offering price):

	At least	But less than	Sales Charge Paid by Investor	Dealer Discount
On investments of	*	$ 10,000	8.5%	7.0%
On investments of	$ 10,000	25,000	8.0%	6.5%
On investments of	25,000	50,000	6.0%	4.8%
On investments of	50,000	100,000	4.5%	3.6%
On investments of	100,000	250,000	3.5%	2.8%
On investments of	250,000	500,000	2.5%	2.0%
On investments of	500,000	1,000,000	2.0%	1.6%
On investments over ...	1,000,000		1.0%	0.8%

* The minimum initial and subsequent investments must be as specified in the then currently effective applicable Fund Prospectus.

The schedule of sales charges and dealer discounts set forth above is applicable to purchases by "any person" (a) of a single Fund at any one time, or (b) in accordance with "Combined Purchase Privilege", "Cumulative Quantity Discount" and/or "Statement of Intention" as each of those terms is described in the then currently effective applicable Fund Prospectus. You must notify us of the total holdings, if applicable, of "any person" before he may avail himself of a reduced sales charge pursuant to the foregoing. Such notification, in writing, must be received by Crosby within four (4) business days of the placing of the order. An application form is available for this purpose. As used in this paragraph, "any person" means an individual, or an individual, his spouse and children under the age of 21, or a trustee, or other like fiduciary of a single trust estate or single fiduciary account, (including a pension, profit-sharing, or other employee benefit trust created pursuant to a plan qualified under Section 401 of the Internal Revenue Code) although more than one beneficiary is involved; provided, however, that the term "any person" shall not include a group of individuals whose funds are combined, directly or indirectly, for the purpose of purchasing shares of any one or more of the Funds jointly or through a trustee, agent, custodian, or other representative, nor shall it include a trustee, agent, custodian, or other representative of such a group of individuals.

If any shares are repurchased by any Fund, or by us for the account of any Fund, or are tendered for redemption within seven (7) business days (Saturdays, Sundays and holidays not being considered business days) after confir-

mation to you of the original purchase order for such shares, you shall forthwith refund to us (or we may retain) the full discount allowed to you on the original sale, and upon receipt thereof we will as soon as practicable thereafter pay to the applicable Fund the full amount of the sales charge on the original sale by us. You will be notified by us of such repurchase or redemption within ten (10) days of the date on which the certificate is delivered to us or to the Fund.

Payment and Delivery

Upon receipt of confirmation you will pay promptly the net amount due as shown thereon. Payment should be made as follows:

The Crosby Corporation
Cash Clearing Department, 3rd Floor
Ten Post Office Square
Boston, Massachusetts 02109

FOR IDENTIFICATION PURPOSES ALL PAYMENTS AND TRANSFER INSTRUCTIONS MUST REFER TO THE INVOICE NUMBER SHOWN ON THE CONFIRMATION. THE RULES OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. REQUIRE US TO NOTIFY THE ASSOCIATION OF ANY PAYMENTS NOT RECEIVED FROM YOU WITHIN TEN BUSINESS DAYS FOLLOWING THE DATE OF A TRANSACTION INVOLVING MORE THAN $100. WE RESERVE THE RIGHT TO HOLD YOU RESPONSIBLE FOR ANY LOSS WE MAY INCUR AS THE RESULT OF YOUR FAILURE TO MAKE ANY SUCH PAYMENTS.

Other Transactions in Fund Shares

You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the net asset value then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the then currently effective applicable Fund Prospectus), unless

such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling to us for the account of an investor any shares of the appropriate Fund at the net asset value price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.

You agree that you will not withhold placing a customer's order in such manner as to profit yourself as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders already received, and then only at the public offering price at which such orders were taken less the dealer discount allowed hereunder. We will not accept a conditional order for shares of the Funds.

Miscellaneous

We reserve the right to amend this Agreement and, in our discretion, to reject in whole or in part any order received by us from you and to terminate this Agreement in the event of violation by you of any of its provisions or for any cause which in our opinion justifies such action. This Agreement shall be in substitution for any prior Sales Agreement between us regarding shares of any of the Funds, and shall terminate automatically in the event of your ceasing to be a member in good standing of the National Association of Securities Dealers, Inc. as you represent yourself to be. All transactions pursuant to this Agreement are subject to and must be in compliance with any and all applicable federal and state laws, including the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the Investment Company Act of 1940, as amended, and the Rules and Regulations thereunder, and any applicable rules of the National Association of Securities Dealers, Inc., particularly rule 26 of the Rules of Fair Practice.

No person is authorized or permitted to give any information or make any representation concerning the Funds other than those which are contained in the then currently effective applicable Fund Prospectus and in such other printed information as may be subsequently issued by us as information supplemental to such Prospectus or approved by us in writing for use in connection therewith. You will not use the words "Fidelity Fund, Inc.," "Puritan Fund, Inc.," "Fidelity Capital Fund, Inc.," "Fidelity Trend Fund,

Inc.," "Salem Fund, Inc.," "Everest Fund, Inc.," "Fidelity Bond-Debenture Fund, Inc.," "Fidelity Group of Funds" or "The Crosby Corporation" whether in writing, by radio or television or any other advertising media without our prior written approval.

Nothing in this Agreement shall be deemed or construed to make you an employee, agent or representative of any of the Funds or of this Corporation, and you are not authorized to act for us or for any of the Funds or to make any representations on our or their behalf. We shall not be liable in any way or for any matter connected herewith, except such as may be incurred under the Securities Act of 1933, as amended, and except for lack of good faith.

This Agreement supersedes and cancels any prior agreement with respect to the sale of shares of any of the Funds for which we are the principal underwriter and we reserve the right to amend this Agreement at any time and from time to time or to terminate the same at any time.

We and/or the Funds in the Fidelity Group of Funds may at any time modify the sales charge and dealer discount to to be paid in connection with the sale of shares of any of those Funds. In the event of any such change you agree that you will have no continuing claim to or vested interest in the level of sales charges or dealer discounts established by this Agreement as to any shares purchased subsequent to such change.

Very truly yours,
THE CROSBY CORPORATION

By ....

The undersigned hereby accepts this Agreement and agrees to abide by all of its terms and conditions.

Dated ...., 19..   Firm ....
By ....
Authorized Signature
Address ....

(Title Omitted in Printing)

MOTION OF DEFENDANT VANCE, SANDERS & COMPANY, INC. TO DISMISS

Defendant Vance, Sanders & Company, Inc. ("Vance, Sanders"), pursuant to Rule 12 of the Federal Rules of Civil Procedure, moves this Court to dismiss the actions herein for failure to state a claim upon which relief can be granted, on the following grounds:

1. Section 22(d) of the Investment Company Act of 1940 (the "Act") applies to brokerage transactions in open-end investment company securities effected by dealers who are parties to a selling group agreement, and thereby prevents such transactions from being carried out at less than the public offering price described in the relevant prospectus. This result follows (a) from the language and history of § 22(d), as well as (b) from the pervasive and comprehensive nature of the regulatory scheme established by the Act over the entire process of distributing and selling open-end investment company securities.
2. Section 22(f) of the Investment Company Act of 1940 authorizes contractual arrangements prohibiting or restricting brokerage transactions effected by dealers who are parties to a selling group agreement filed as part of the registration statement of the relevant mutual fund.

The defendant Vance, Sanders further moves this Court, if, but only if, the Court is unable at this time to grant the motion to dismiss on any of the above-stated grounds, to dismiss so much of the actions as are dependent upon allegations that the Vance, Sanders Selling Group Agreement prohibits brokerage transactions at less than the applicable public offering price. The grounds for this alternative motion are as follows:

1. On its face the written Vance, Sanders Selling Group Agreement clearly does not prohibit dealers from engaging in brokerage transactions at less than the public offering price.
2. Should the Court interpret the Selling Group Agreement as prohibiting such transactions, the crucial

provision of the Selling Group Agreement (¶ 5(a)) must be recognized as substantially identical to Rule of Fair Practice 26(e) of the National Association of Securities Dealers, Inc. ("NASD"). Antitrust liability cannot be based on provisions in a selling group agreement that are substantially identical to a validly promulgated NASD Rule of Fair Practice which has not been abrogated by the Securities and Exchange Commission.

The grounds in support of this Motion are more fully set forth in the memorandum which is filed herewith pursuant to Rule 9(b) of the Rules of this Court.

VANCE, SANDERS & COMPANY, INC.
By ....

Herbert J. Miller
Miller, Cassiday, Larroca & Lewin
1320 19th Street, N.W.
Washington, D.C. 20036
(202) 293-6400

....

Ropes & Gray
225 Franklin Street
Boston, Massachusetts 02110
(617) 423-6100

May 29, 1973

(Title Omitted in Printing)

MOTION TO DISMISS

Defendants Wellington Management Company and Wellington Fund, Inc.[1] move this Court to dismiss the complaints herein for failure to state a claim upon which relief can be granted because:

1. The allegedly unlawful conduct is exempt from antitrust liability by the provisions of Section 22(d) of the Investment Company Act of 1940.

2. The allegedly unlawful activities of defendants are within the exclusive jurisdiction of the Securities and Exchange Commission.

The grounds in support of this motion are fully set forth in the Memorandum of Points and Authorities which is filed herewith pursuant to Rule 9(b) of the Rules of this Court.

WILLIAMS & JENSEN, P.C.

/s/ Robert E. Jensen
ROBERT E. JENSEN
1130 17th Street, N.W.
Washington, D.C. 20036
(202) 223-6150

HILL, CHRISTOPHER & PHILLIPS, P.C.

/s/ Richard M. Phillips
RICHARD M. PHILLIPS

/s/ Robert A. Wittie
ROBERT A. WITTIE
2000 L Street, N.W.
Washington, D.C. 20036
(202) 833-3990

Attorneys For
Wellington Management Company
Wellington Fund, Inc.

[1] Wellington Fund, Inc. is not named as a defendant in *Haddad v. The Crosby Corporation, et al.*

(Title Omitted in Printing)

MOTION OF BACHE & CO., ET AL. TO DISMISS

Defendants Bache & Co. Incorporated; Dean Witter & Co. Incorporated; duPont Glore Forgan Incorporated; E. F. Hutton & Company Inc.; Hornblower & Weeks-Hemphill Noyes Incorporated; Merrill Lynch, Pierce, Fenner & Smith Inc.; Paine, Webber, Jackson & Curtis Incorporated; Reynolds Securities Inc.; and Walston & Co. Inc. ("the defendant dealers"), pursuant to Rule 12 of the Federal Rules of Civil Procedure, move this Court to dismiss the Complaint herein for failure to state a claim upon which relief can be granted, and in support thereof urge as follows:

1. Section 22(d) of the Investment Company Act of 1940 creates an exemption and immunity from antitrust liability for the defendant dealers' conduct in maintaining the public offering price of investment company securities.
2. Section 22(f) of the Investment Company Act of 1940 creates an exemption and immunity from antitrust liability for any restrictions on transferability imposed by the defendant dealers' agreements for distribution of investment company securities.
3. Under the Investment Company Act, Congress subjected the acts and practices of the defendant dealers in the distribution of investment company securities to continuous and pervasive regulation by the SEC, and the NASD acting under the SEC's supervision; and accordingly the SEC has exclusive jurisdiction to regulate those acts and practices, and such acts and practices are exempt and immune from the claims herein alleged for violation of the federal antitrust laws.

The defendant dealers further move this Court, if, but only if, the Court does not grant their motion to dismiss at this time, to refer the case to the SEC, pursuant to its primary jurisdiction over such matters.

The grounds in support of this Motion are more fully set

forth in the memorandum which is filed herewith pursuant to Rule 9(b) of the Rules of this Court.

HOGAN & HARTSON

By: ....
Lee Loevinger

....
Owen M. Johnson, Jr.

....
Timothy J. Bloomfield

....
David J. Saylor
815 Connecticut Avenue, N.W.
Washington, D.C. 20006
202-298-5500

Attorneys for defendants

Bache & Co. Incorporated
Dean Witter & Co. Incorporated
duPont Glore Forgan Incorporated
E. F. Hutton & Company Inc.
Hornblower & Weeks-Hemphill Noyes Incorporated
Merrill Lynch, Pierce, Fenner & Smith Inc.
Paine, Webber, Jackson & Curtis Incorporated
Reynolds Securities Inc.
Walston & Co. Inc.

BROWN, WOOD, FULLER, CALDWELL & IVEY
One Liberty Plaza
New York, New York 10006

Of counsel for defendant Merrill Lynch, Pierce, Fenner & Smith Inc.

DATED: May 29, 1973

(Title Omitted in Printing)

AFFIDAVIT

Daniel R. Hunter, being first duly sworn, deposes and says:

1. I am the attorney in charge of preparing this case for trial on behalf of the plaintiff, United States of America.

2. Beginning in April, 1972 the Department of Justice commenced an investigation into possible antitrust violations in the distribution of mutual fund shares. Certain documents were requested and received from the files of a number of mutual fund underwriters, a number of broker/dealers, the National Association of Securities Dealers ("NASD") and other parties.

3. The documents received, which, on information and belief, were prepared or received in the regular course of business by the above-mentioned parties, tend to prove the facts set forth in "Plaintiff's First Request for Admissions" a copy of which has been filed with the court and another copy of which is attached hereto as Exhibit A. On information and belief, the facts stated in Exhibit A are true and are incorporated as if stated in full herein.

4. In order to show that the statements set forth in Exhibit A have a reasonable basis, plaintiff hereby attaches certain documents as exhibits to this affidavit. These documents will be identified as to source and subject matter in the succeeding paragraphs of this affidavit.

5. Government exhibits ("GX") 1 through 6 were obtained from the Securities and Exchange Commission. GX 1-3 are specimen share certificates of defendant mutual funds; GX 4 is a specimen certificate of Quasar Associates, Inc., included for purposes of comparison. GX 5 consists of a recent exchange of correspondence between a mutual fund advisor/underwriter and an SEC official reaffirming the Commission's position that brokerage transactions, at less than the public offering price, are legal under section 22(d) of the Investment Company Act. GX 6 is a memorandum of meeting between SEC staff and NASD officials concerning the NASD's effort to Interpret an NASD Rule in a manner calculated to inhibit secondary markets in mutual fund shares. See GX 14-19.

6. GX 7-9 are pages from mutual fund prospectuses. GX

7 and 8 show prospectus representations as to the transferability of Fidelity Fund shares and Massachusetts Investors Growth Stock Fund shares, respectively. GX 9, included for purposes of comparison, shows the prospectus representation as to limitations on transferability of Quasar Associates shares.

7. GX 10 and 11 were obtained from defendant broker-dealers Paine, Webber, Jackson & Curtis and Merrill Lynch, Pierce, Fenner & Smith respectively. They are pages from internal operating manuals showing both firms utilization of the secondary dealer market ("grey market") to acquire shares of mutual funds with which they did not have signed distribution agreements.

8. GX 12 and 13 were obtained from defendant underwriters Vance, Sanders and Company and Crosby Corporation, respectively. GX 12, written by Henry Vance, first chairman of the NASD's Investment Trust Committee, shows awareness of the competitive impact of secondary market activities and the anticompetitive aspects of selling group agreements. GX 13 illustrates awareness of the applicability of the antitrust laws to restrictive provisions in underwriter-dealer contracts.

9. GX 14-30 were obtained from defendant National Association of Securities Dealers. GX 14-19 concern the NASD's effort to Interpret an NASD Rule in a manner calculated to inhibit secondary market activities. The effort was spearheaded by the Investment Companies Committee ("ICC") despite the admonition of one of its members that the relevant Rule would not support the desired Interpretation, GX 14. The proposal was carried to the SEC staff which rejected it for want of statutory support, GX 15, (marginal motation), GX 16, and GX 6. Having been rebuffed in an effort accomplish its objective through prescribed procedures, the NASD's ICC decided to contact all fund underwriters and distributors and urge the insertion in distribution agreements, and the strict enforcement of, restrictive provisions of the type here challenged, GX 17 and GX 19. A letter embodying the proposal was sent June 22, 1959, GX 18.

10. GX 20-23 illustrate defendants' awareness of the existence, utility, and legality of the inter-dealer market. GX 20 is a transcript of a conference presided over by Henry Vance. The conference apparently was attended by

the NASD's District Secretaries and occurred circa 1943. GX 23 is a memorandum from Ray Moulden, secretary of the NASD Investment Companies Committee to Wallace Fulton, executive director of the NASD. GX 24-30 illustrate defendants' acknowledgment of the legality of brokerage transactions. See also GX 20. Robert L. Cody, author of GX 29-30, was a member of the NASD's Investment Companies Committee.

/s/ Daniel R. Hunter
DANIEL R. HUNTER

(Jurat Omitted in Printing)

UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION

ATTESTATION

I HEREBY ATTEST that attached are full, true and complete copies of:

Exhibits Nos. 4 and 4a as contained in amendment filed January 19, 1965 to registration statement filed with this Commission January 12, 1959 by Massachusetts Investors Growth Stock Fund, Inc., pursuant to the provisions of the Securities Act of 1933, as amended, under File No. 2-14677

on file in this Commission

June 4, 1973
(Date)

ERNEST L. DESSECKER
RECORDS & SERVICE OFFICER

It is hereby certified that ERNEST L. DESSECKER, Records Officer of the Securities and Exchange Commission, Washington, D.C., which Commission was created by the Securities Exchange Act of 1934 (15 USCA Sec. 78a et seq.), is official custodian of the books and records of said Commission, and all books and records created or established by the Federal Trade Commission pursuant to the provisions of the Securities Act of 1933 and transferred to this Commission in accordance with Section 210 of the Securities Exchange Act of 1934, and was such official custodian at the time of executing the above attestation, and that he, and his subordinate, CHARLES A. MOORE, Deputy Records Officer, are authorized to execute the above attestation.

By the Commission.

Secretary

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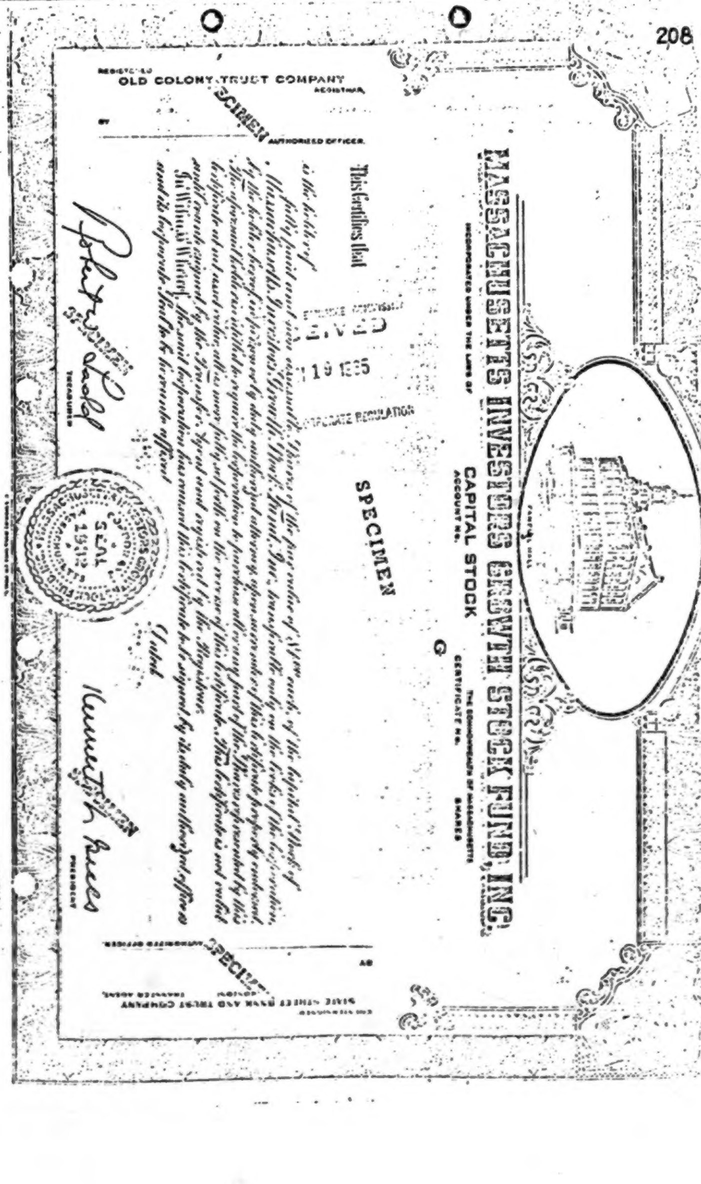

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF MASSACHUSETTS

CAPITAL STOCK

ACCOUNT No. CERTIFICATE No. SHARES

G

SPECIMEN

This Certifies that

is the holder of

fully paid and non-assessable Shares of the par value of $1.00 each, of the Capital Stock of Massachusetts Investors Growth Stock Fund, Inc., transferable only on the books of the Corporation, by the holder hereof in person or by duly authorized attorney, upon surrender of this Certificate properly endorsed. The aforesaid holder is entitled to require the Corporation to purchase all or any part of the Shares represented by this Certificate at net asset value, all as more fully set forth on the reverse of this Certificate. This Certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar.

In Witness Whereof, the said Corporation has caused this Certificate to be signed by its duly authorized officers and its Corporate Seal to be hereunto affixed.

Dated

Robert W. Ladd
TREASURER

Kenneth L. Isaacs
PRESIDENT

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC. CORPORATE SEAL 1932 MASSACHUSETTS

REGISTERED
OLD COLONY TRUST COMPANY
REGISTRAR
BY
AUTHORIZED OFFICER.

COUNTERSIGNED
STATE STREET BANK AND TRUST COMPANY
BOSTON TRANSFER AGENT.
BY
AUTHORIZED OFFICER.

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

THE REPURCHASE PROVISION CONTAINED IN ARTICLE VII OF THE AGREEMENT OF ASSOCIATION AND ARTICLES OF ORGANIZATION AS IN EFFECT FEBRUARY 27, 1959, PROVIDES AS FOLLOWS:

(a) IN CASE ANY SHAREHOLDER IN THE CORPORATION AT ANY TIME DESIRES TO DISPOSE OF SHARES RECORDED IN HIS NAME, HE MAY DEPOSIT HIS CERTIFICATE OR CERTIFICATES THEREFOR DULY ENDORSED OR ACCOMPANIED BY A PROPER INSTRUMENT OF TRANSFER AT THE OFFICE OF THE CUSTODIAN TOGETHER WITH A REQUEST THAT THE CORPORATION PURCHASE THE SHARES REPRESENTED THEREBY IN ACCORDANCE WITH THIS ARTICLE VII (a). THE SHAREHOLDER SO DEPOSITING HIS CERTIFICATE OR CERTIFICATES SHALL BE ENTITLED TO REQUIRE THE CORPORATION TO PURCHASE, AND THE CORPORATION SHALL PURCHASE, HIS SAID SHARES, BUT ONLY AT THE NET ASSET VALUE OF SUCH SHARES (AS DEFINED IN ARTICLE VIII HEREOF) DETERMINED BY OR ON BEHALF OF THE BOARD OF DIRECTORS AS OF THE CLOSE OF BUSINESS ON THE DAY ON WHICH SUCH SHARES ARE SO DEPOSITED IF THAT IS A DAY, OTHER THAN SATURDAY, UPON WHICH A DETERMINATION OF NET ASSET VALUE AS OF THE CLOSE OF BUSINESS IS REQUIRED BY SAID ARTICLE VIII TO BE MADE OR IS MADE AND IF SUCH SHARES ARE DEPOSITED AT OR PRIOR TO TWELVE O CLOCK NOON ON THAT DAY. IF THE DAY OF DEPOSIT IS NOT SUCH A DAY OR IF SUCH SHARES ARE DEPOSITED AFTER TWELVE O CLOCK NOON, THEN THE PURCHASE PRICE SHALL BE THE NET ASSET VALUE PER SHARE AS OF THE CLOSE OF BUSINESS ON THE FIRST DAY UPON WHICH A DETERMINATION OF NET ASSET VALUE IS SO MADE OR REQUIRED TO BE MADE NEXT SUCCEEDING THE DATE ON WHICH SUCH SHARES ARE SO DEPOSITED.

PAYMENT FOR SUCH SHARES SHALL BE MADE BY THE CORPORATION TO THE SHAREHOLDER OF RECORD WITHIN SEVEN (7) DAYS AFTER THE DATE UPON WHICH THE SHARES ARE DEPOSITED. IF THE DETERMINATION OF THE PURCHASE PRICE IS POSTPONED BEYOND THE DATE ON WHICH IT WOULD NORMALLY OCCUR BY REASON OF A DECLARATION BY THE BOARD OF DIRECTORS SUSPENDING DETERMINATION OF NET ASSET VALUE PURSUANT TO SAID ARTICLE VIII, THE RIGHT OF THE SHAREHOLDER TO HAVE HIS SHARES PURCHASED BY THE CORPORATION SHALL BE SIMILARLY SUSPENDED, AND HE MAY WITHDRAW HIS CERTIFICATE OR CERTIFICATES FROM DEPOSIT IF HE SO ELECTS; OR IF HE DOES NOT SO ELECT, THE PURCHASE PRICE SHALL BE THE NET ASSET VALUE OF THE SHARES DEPOSITED, DETERMINED AS OF THE CLOSE OF BUSINESS UPON THE FIRST DAY AFTER THE SUSPENSION UPON WHICH SUCH A DETERMINATION IS MADE, AND PAYMENT THEREFOR SHALL BE MADE WITHIN SEVEN (7) DAYS AFTER SUCH FIRST DAY.

(b) THE CORPORATION MAY, HOWEVER, PURCHASE SHARES OF THE CORPORATION BY AGREEMENT WITH THE OWNER THEREOF (1) AT A PRICE NOT EXCEEDING THE NET ASSET VALUE PER SHARE IN EFFECT AT THE TIME WHEN THE PURCHASE OR CONTRACT OF PURCHASE IS MADE OR (2) AT A PRICE NOT EXCEEDING THE NET ASSET VALUE PER SHARE TO BECOME EFFECTIVE AT SOME LATER TIME.

(c) SHARES PURCHASED BY THE CORPORATION EITHER PURSUANT TO PARAGRAPH (a) OR PARAGRAPH (b) OF THIS ARTICLE VII SHALL BE DEEMED TREASURY SHARES AND MAY BE RESOLD BY THE CORPORATION.

FOR VALUE RECEIVED____________ HEREBY SELL, ASSIGN AND TRANSFER UNTO

____

____

______________________________________ SHARES

OF THE MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC. REPRESENTED BY THE WITHIN CERTIFICATE AND DO HEREBY IRREVOCABLY CONSTITUTE AND APPOINT

______________________________________ ATTORNEY,

TO TRANSFER THE SAID STOCK ON THE BOOKS OF THE SAID FUND WITH FULL POWER OF SUBSTITUTION IN THE PREMISES.

DATED,__________________ 19__

(SIGN HERE)__________________________

SIGNATURE GUARANTEE

____

SIGNATURE MUST BE GUARANTEED BY A NATIONAL BANK OR TRUST COMPANY OR BY A MEMBER FIRM OF THE BOSTON OR NEW YORK STOCK EXCHANGE.

[illegible] THIS ASSIGNMENT MUST [illegible] UPON THE [illegible] EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER.

MASSACHUSETTS INVESTORS' GROWTH STOCK FUND, INC.

INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF MASSACHUSETTS

CAPITAL STOCK

ACCOUNT No. CERTIFICATE No. G SHARES

SECURITIES AND EXCHANGE CO
RECEIVED
JAN 19 1956
DIVISION OF CORPORATE RE

This Certifies that

is the holder of

fully paid and non-assessable Shares of the par value of $1.00 each, of the Capital Stock of Massachusetts Investors Growth Stock Fund, Inc., transferable only on the books of the Corporation, by the holder hereof, in person or by duly authorized attorney, upon surrender of this Certificate properly endorsed. The aforesaid holder is entitled to require the Corporation to purchase all or any part of the Shares represented by this Certificate at net asset value, all as more fully set forth on the reverse of this Certificate. This Certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar.

In Witness Whereof, the said Corporation has caused this Certificate to be signed by its duly authorized officers and its Corporate Seal to be hereunto affixed.

Dated

SPECIMEN
TREASURER

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC. CORPORATE SEAL 1932 MASSACHUSETTS

SPECIMEN
PRESIDENT

REGISTERED:
OLD COLONY TRUST COMPANY
REGISTRAR,
BY
AUTHORIZED OFFICER.

COUNTERSIGNED:
STATE STREET BANK AND TRUST COMPANY
(BOSTON)
TRANSFER AGENT,
BY
AUTHORIZED OFFICER.

MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

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(a) IN CASE ANY SHAREHOLDER IN THE CORPORATION AT ANY TIME DESIRES TO DISPOSE OF SHARES RECORDED IN HIS NAME, HE MAY DEPOSIT HIS CERTIFICATE OR CERTIFICATES THEREFOR DULY ENDORSED OR ACCOMPANIED BY A PROPER INSTRUMENT OF TRANSFER AT THE OFFICE OF THE CUSTODIAN TOGETHER WITH A REQUEST THAT THE CORPORATION PURCHASE THE SHARES REPRESENTED THEREBY IN ACCORDANCE WITH THIS ARTICLE VII (A THE SHAREHOLDER SO DEPOSITING HIS CERTIFICATE OR CERTIFICATES SHALL BE ENTITLED TO REQUIRE THE CORPORATION TO PURCHASE, AND THE CORPORATION SHALL PURCHASE, HIS SAID SHARES, BUT ONLY AT THE NET ASSET VALUE OF SUCH SHARES (AS DEFINED IN ARTICLE VIII HEREOF) DETERMINED BY OR ON BEHALF OF THE BOARD OF DIRECTORS AS OF THE CLOSE OF BUSINESS ON THE DAY ON WHICH SUCH SHARES ARE SO DEPOSITED IF THAT IS A DAY, OTHER THAN SATURDAY, UPON WHICH A DETERMINATION OF NET ASSET VALUE AS OF THE CLOSE OF BUSINESS IS REQUIRED BY SAID ARTICLE VIII TO BE MADE OR IS MADE AND IF SUCH SHARES ARE DEPOSITED AT OR PRIOR TO TWELVE O'CLOCK NOON ON THAT DAY. IF THE DAY OF DEPOSIT IS NOT SUCH A DAY OR IF SUCH SHARES ARE DEPOSITED AFTER TWELVE O'CLOCK NOON, THEN THE PURCHASE PRICE SHALL BE THE NET ASSET VALUE PER SHARE AS OF THE CLOSE OF BUSINESS ON THE FIRST DAY UPON WHICH A DETERMINATION OF NET ASSET VALUE IS SO MADE OR REQUIRED TO BE MADE NEXT SUCCEEDING THE DATE ON WHICH SUCH SHARES ARE SO DEPOSITED.

PAYMENT FOR SUCH SHARES SHALL BE MADE BY THE CORPORATION TO THE SHAREHOLDER OF RECORD WITHIN SEVEN (7) DAYS AFTER THE DATE UPON WHICH THE SHARES ARE DEPOSITED. IF THE DETERMINATION OF THE PURCHASE PRICE IS POSTPONED BEYOND THE DATE ON WHICH IT WOULD NORMALLY OCCUR BY REASON OF A DECLARATION BY THE BOARD OF DIRECTORS SUSPENDING DETERMINATION OF NET ASSET VALUE PURSUANT TO SAID ARTICLE VIII, THE RIGHT OF THE SHAREHOLDER TO HAVE HIS SHARES PURCHASED BY THE CORPORATION SHALL BE SIMILARLY SUSPENDED, AND HE MAY WITHDRAW HIS CERTIFICATE OR CERTIFICATES FROM DEPOSIT IF HE SO ELECTS; OR IF HE DOES NOT SO ELECT, THE PURCHASE PRICE SHALL BE THE NET ASSET VALUE OF THE SHARES DEPOSITED, DETERMINED AS OF THE CLOSE OF BUSINESS UPON THE FIRST DAY AFTER THE SUSPENSION UPON WHICH SUCH A DETERMINATION IS MADE, AND PAYMENT THEREFOR SHALL BE MADE WITHIN SEVEN (7) DAYS AFTER SUCH FIRST DAY.

(b) THE CORPORATION MAY, HOWEVER, PURCHASE SHARES OF THE CORPORATION BY AGREEMENT WITH THE OWNER THEREOF (1) AT A PRICE NOT EXCEEDING THE NET ASSET VALUE PER SHARE IN EFFECT AT THE TIME WHEN THE PURCHASE OR CONTRACT OF PURCHASE IS MADE OR (2) AT A PRICE NOT EXCEEDING THE NET ASSET VALUE PER SHARE TO BECOME EFFECTIVE AT SOME LATER TIME.

(c) SHARES PURCHASED BY THE CORPORATION EITHER PURSUANT TO PARAGRAPH (a) OR PARAGRAPH (b) OF THIS ARTICLE VII SHALL BE DEEMED TREASURY SHARES AND MAY BE RESOLD BY THE CORPORATION.

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws:

- **TEN IN COM** - as tenants in common
- **TEN BY ENT** - as tenants by the entireties
- **JTWROS** - as joint tenants with right of survivorship and not as tenants in common
- **UNIF GIFTS TO MIN A** - Uniform Gifts to Minors Act

Additional abbreviations may also be used though not in the above list.

FOR VALUE RECEIVED ____________________ HEREBY SELL, ASSIGN AND TRANSFER UNTO

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

____________________ SHARES

OF THE MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC. REPRESENTED BY THE WITHIN CERTIFICATE AND DO HEREBY IRREVOCABLY CONSTITUTE AND APPOINT

____________________ ATTORNEY,

TO TRANSFER THE SAID STOCK ON THE BOOKS OF THE SAID FUND WITH FULL POWER OF SUBSTITUTION IN THE PREMISES.

DATED, ____________ 19____

(SIGN HERE) ____________________

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER.

SIGNATURE GUARANTEE

SIGNATURE MUST BE GUARANTEED BY A NATIONAL BANK OR TRUST COMPANY OR BY A MEMBER FIRM OF THE BOSTON OR NEW YORK STOCK EXCHANGE.

UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION

ATTESTATION

I HEREBY ATTEST that attached is a full, true and complete copy of:

Exhibit No. A as contained in quarterly report on Form N-1Q for quarter ended September 30, 1971 filed with this Commission October 29, 1971 by Wellington Fund, Inc., pursuant to the provisions of the Investment Company Act of 1940, under File No. 811-121

on file in this Commission

June 4, 1973
(Date)

ERNEST L. DESSECKER
RECORDS & SERVICE OFFICER

It is hereby certified that ERNEST L. DESSECKER, Records Officer of the Securities and Exchange Commission, Washington, D.C., which Commission was created by the Securities Exchange Act of 1934 (15 USCA Sec. 78a et seq.), is official custodian of the books and records of said Commission, and all books and records created or established by the Federal Trade Commission pursuant to the provisions of the Securities Act of 1933 and transferred to this Commission in accordance with Section 210 of the Securities Exchange Act of 1934, and was such official custodian at the time of executing the above attestation, and that he, and his subordinate, CHARLES A. MOORE, Deputy Records Officer, are authorized to execute the above attestation.

By the Commission.

Secretary

GOVERNMENT EXHIBIT
2

213 [illegible]7149

Exhibit No. A

CERTIFICATE NO. SHARES

WELLINGTON FUND

A WELLINGTON MANAGEMENT COMPANY MUTUAL FUND

Incorporated under the laws of the State of Delaware

SPECIMEN

See reverse for certain definitions

CUSIP 949527 10 5

Treasurer President

Countersigned
DATA-SYS-TANCE, INC.
By

Authorized Signature

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

TEN COM—as tenants in common

TEN ENT—as tenants by the entireties

JT TEN —as joint tenants with right of survivorship and not as tenants in common

UNIF GIFT MIN ACT—........ Custodian ....
(Cust) (Minor)
under Uniform Gifts to Minors
Act........
(State)

Additional abbreviations may also be used though not in the above list.

For value received, ________ *hereby sell, assign and transfer unto*

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

____

PLEASE PRINT OR TYPEWRITE NAME AND ADDRESS, INCLUDING ZIP CODE, OF ASSIGNEE

____

____

____ *shares*

of the capital stock represented by the within Certificate, and do hereby irrevocably constitute and appoint

____ *Attorney*

to transfer the said stock on the books of the within named Corporation with full power of substitution in the premises.

Dated ________________

NOTICE: [illegible]

SIGNATURE GUARANTEED

____

SIGNATURE OF SELLER MUST BE GUARANTEED

THIS SPACE MUST NOT BE COVERED IN ANY WAY

UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION

ATTESTATION

I HEREBY ATTEST that attached is a full, true and complete copy of:

Exhibit 2. as contained in registration statement filed with this Commission March 9, 1951 by Fidelity Fund, Inc., pursuant to the provisions of the Securities Act of 1933, as amended, under File No. 2-8850

on file in this Commission

June 7, 1973
(Date)

ERNEST L. DESSECKER
RECORDS & SERVICE OFFICER

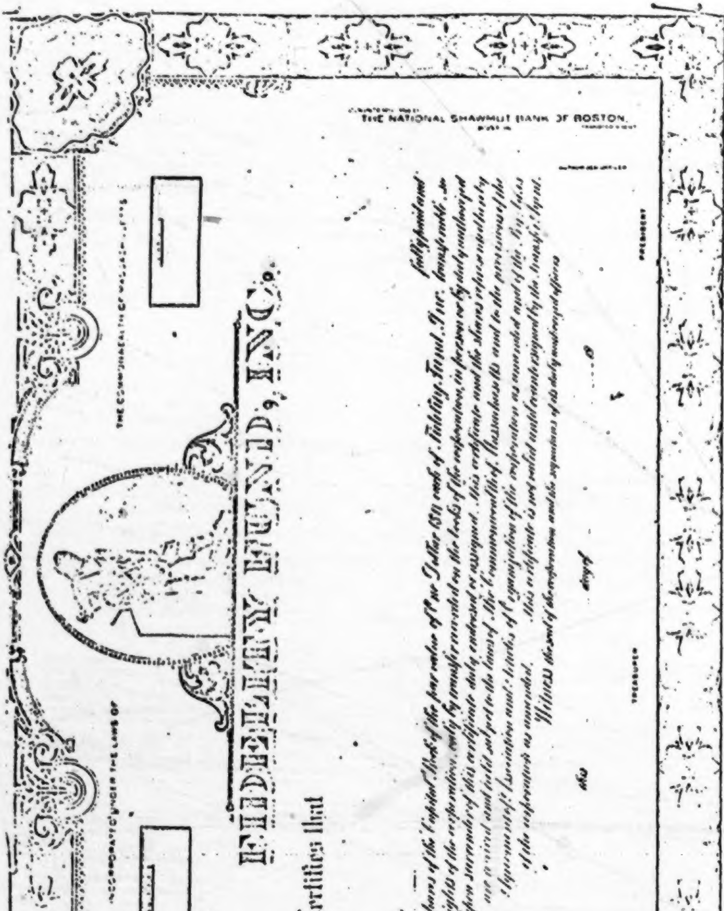
It is hereby certified that ERNEST L. DESSECKER, Records Officer of the Securities and Exchange Commission, Washington, D.C., which Commission was created by the Securities Exchange Act of 1934 (15 USCA Sec. 78a et seq.), is official custodian of the books and records of said Commission, and all books and records created or established by the Federal Trade Commission pursuant to the provisions of the Securities Act of 1933 and transferred to this Commission in accordance with Section 210 of the Securities Exchange Act of 1934, and was such official custodian at the time of executing the above attestation, and that he, and his subordinate, CHARLES A. MOORE, Deputy Records Officer, are authorized to execute the above attestation.

By the Commission

Secretary

GOVERNMENT EXHIBIT
3

EXHIBIT 2.



INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF MASSACHUSETTS

FIDELITY FUND, INC.

This Certifies that

is the owner of fully paid and non-assessable shares of the Capital Stock of the par value of One Dollar ($1) each of Fidelity Fund, Inc. transferable so as to affect the rights of the corporation, only by transfer recorded on the books of the corporation, in person or by duly authorized attorney, and upon surrender of this certificate duly endorsed or assigned. This certificate and the shares represented hereby are received and held subject to the laws of The Commonwealth of Massachusetts and to the provisions of the Agreement of Association and Articles of Organization of the corporation as amended and of the By-laws of the corporation as amended. This certificate is not valid until countersigned by the Transfer Agent.

Witness the seal of the corporation and the signatures of its duly authorized officers

this day of 19

TREASURER PRESIDENT

THE NATIONAL SHAWMUT BANK OF BOSTON

UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION

ATTESTATION

I HEREBY ATTEST that attached is a full, true and complete copy of:

Exhibit No. A-4a-1 as contained in amendment filed December 27, 1968 to notification on Form N-8A filed with this Commission August 15, 1968 by Quasar Associates, Inc., pursuant to the Investment Company Act of 1940, under File No. 811-1716

on file in this Commission

June 12, 1973
(Date)

ERNEST L. DESSECKER
RECORDS & SERVICE OFFICER

It is hereby certified that ERNEST L. DESSECKER, Records Officer of the Securities and Exchange Commission, Washington, D.C., which Commission was created by the Securities Exchange Act of 1934 (15 USCA Sec. 78a et seq.), is official custodian of the books and records of said Commission, and all books and records created or established by the Federal Trade Commission pursuant to the provisions of the Securities Act of 1933 and transferred to this Commission in accordance with Section 210 of the Securities Exchange Act of 1934, and was such official custodian at the time of executing the above attestation, and that he, and his subordinate, CHARLES A. MOORE, Deputy Records Officer, are authorized to execute the above attestation.

By the Commission

Secretary

Exhibit A- [illegible]

Listed as Ite[illegible]
under Item 3[illegible]
Form N-8B-1

No. QU

QUASAR ASSOCIATES, INC.

COMMON STOCK

For ______________ Shares

Issued to

____

____

Dated ______________ 19__

Transferred from

____

Dated ______________ 19__

No. of Original Certificate	No. of Original Shares	No. of Shares Transferred

Received this Certificate

______________ 19__

____

Surrendered ______________ 19__

No. Certificate No. ______________

[illegible] ______________ 19__

T29805--Quasar Associates--(Certificate)--Secol. F4- 61, 65--Bor. 219--) Proof 4

THE CERTIFICATE OF INCORPORATION OF THE CORPORATION PROVIDES THAT THE SHARES EVIDENCED HEREBY MAY NOT BE TRANSFERRED WITHOUT THE CONSENT OF THE BOARD OF DIRECTORS OF THE CORPORATION AND THAT THE CORPORATION, AT ITS OPTION, MAY PURCHASE THE SHARES EVIDENCED BY ANY CERTIFICATE UPON PRESENTATION FOR TRANSFER OR UPON THE OCCURRENCE OF CERTAIN OTHER EVENTS. THE PROVISIONS OF THE CORPORATION'S CERTIFICATE OF INCORPORATION AND BY-LAWS RELATING TO THE FOREGOING APPEAR ON THE REVERSE OF THIS CERTIFICATE.

No. QU

______________ SHAR[illegible]

QUASAR ASSOCIATES, INC.

INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE

Exhibit A-4a-1

THIS IS TO CERTIFY THAT

is the owner of

fully paid and non-assessable shares of Common Stock of the par value of $.10 each of QUASAR ASSOCIATES, INC. (herein called th[illegible] poration") transferable on the books of the Corporation in person or by attorney duly authorized in writing upon surrender of this ce[illegible] properly endorsed, subject to the above-mentioned provisions restricting the right to transfer the shares evidenced hereby. The holder he[illegible] accepting this certificate expressly assents to and is bound by the Certificate of Incorporation, as amended, and the By-Laws, as amended [illegible] Corporation, copies of which are available for inspection at the office of the Corporation.

WITNESS the seal of the Corporation and the signatures of its duly authorized officers.

Dated ______________

____
Secretary
Treasurer

____
Chairman of the Board
President
Vice-President

QUASAR ASSOCIATES, INC.

PROVISIONS OF CERTIFICATE OF INCORPORATION AND BY-LAWS RESTRICTING TRANSFERABILITY OF SHARES

Certificate of Incorporation

FOURTH. The total number of shares of capital stock which the Corporation shall have authority to issue is two hundred thousand (200,000), all of which shall be of one class and shall be Common Stock at the par value of ten cents ($.10) per share, having an aggregate par value of twenty thousand dollars ($20,000). Such shares and the holders thereof shall be subject to the following provisions:

(a) No transfer or constitution of transfer of such shares may be effected without the consent of the Board of Directors thereto.

(b) In addition to and without limitation of the provisions of the foregoing paragraph (a) of this Article, to the extent permitted by law, the Corporation, in its sole and absolute discretion, acting by its Board of Directors or any officer or officers designated by the Board of Directors, upon presentation for transfer of any certificate evidencing Common Stock of the Corporation, may purchase for the Corporation, without prior notice, the share or shares of Common Stock represented by such certificate by paying therefor a sum in cash equal to the net asset value of such share or shares computed in accordance with Article SEVENTH hereof.

(c) The Corporation in its sole and absolute discretion, acting by its Board of Directors or any officer or officers designated by the Board, may, upon thirty days' written notice mailed to the last known address of the stockholder in question as shown on the books of the Corporation, by certified mail, postage prepaid, purchase for the Corporation all of the shares registered in the name of a stockholder or group of stockholders related by family or business connections whose total investment in the Corporation has been reduced to an amount of less than $100,000, as a result of one or more redemptions of stock pursuant to paragraph (d), or of one or more purchases of stock pursuant to paragraph (b), of this Article FOURTH, by paying therefor a sum in cash equal to the net asset value of such shares computed in accordance with Article SEVENTH hereof. For purposes of the immediately preceding sentence, the amount of the investment of a stockholder or a group of stockholders in the Corporation shall be deemed to be the total net asset value of the shares comprising such investment computed after the particular redemption or purchase of shares referred to in the immediately preceding sentence in accordance with Article SEVENTH hereof.

* * *

By-Laws

Section 7 of Article VII. (a) The Board of Directors in its sole and absolute discretion, upon presentation for transfer of any certificate evidencing Common Stock of the Corporation, may purchase for the Corporation, without prior notice, the share or shares of Common Stock represented by such certificate by paying therefor a sum in cash equal to the net asset value of such share or shares, computed in accordance with the certificate of incorporation and these by-laws, as of the close of business on the day the certificate for such share or shares is received for transfer, unless such day is one on which net asset value is not determinable, in which event the net asset value shall be determined as of the close of business on the next succeeding day when net asset value is determinable, provided, however, that written notice to the transferor and proposed transferee of such share or shares of such purchase must be given within seven days following the date of the receipt of the certificate representing such share or shares and payment of the purchase price shall be made as soon as is reasonably practicable thereafter.

(b) The Board of Directors in its sole and absolute discretion may pursuant to the certificate of incorporation and upon thirty days' written notice mailed to the last known address of the stockholder in question as shown on the books of the Corporation by certified mail, postage prepaid, purchase for the Corporation all of the shares registered in the name of a stockholder or group of stockholders related by family or business connections whose total investment in the Corporation has been reduced to less than $100,000 in aggregate net asset value, as a result of one or more redemptions of stock made by the Corporation upon request by such stockholder or any member of such group of stockholders pursuant to the certificate of incorporation or of one or more purchases of stock by the Corporation pursuant to paragraph (a) of this Section, by paying therefor a sum in cash equal to the net asset value of such shares computed in accordance with the certificate of incorporation and these by-laws, as of the close of business on the day on which such notice is mailed, provided that payment of the purchase price shall be made as soon as is reasonably practicable thereafter.

(c) The Board of Directors may authorize one or more officers or agents of the Corporation to exercise its right to purchase any Common Stock of the Corporation in specific cases or generally.

For Value Received,..................**hereby sell, assign and transfer**

Please insert social security or other identifying number of assignee

[ ] ________________

unto..

(Please print or typewrite name and address of assignee)

....

....

....**shares**

of the Common Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint..

....**Attorney to transfer the said stock on the books of the within-named Corporation with full power of substitution in the premises.**

Dated,..........................

....

NOTICE: The signature to this assignment must correspond with the name as written upon the face of this certificate, in every particular, without alteration or enlargement, or any change whatever.

Government Exhibit 5

GEORGE A. BAILEY & CO.

Investment Securities
1304 Philadelphia National Bank Building
Philadelphia, Pa. 19107

Members
Philadelphia—Baltimore—Washington
Stock Exchange

January 31, 1973

Securities and Exchange Commission
Division of Investment Company Regulation
500 North Capitol Street
Washington, D.C. 20549

Gentlemen:

This firm acts as investment adviser and underwriter for Sovereign Investors, a registered investment company.

We have been asked by one of the broker-dealers who has a selling agreement with us if they can net purchase orders and orders for liquidation of the Fund's shares, received by them on the same day.

If, for example, the dealer had an order for the purchase of 100 shares and another order for the liquidation of 50 shares, could he buy 50 shares from the Fund's underwriter and use the 50 shares being liquidated to complete the 100 share purchase order.

The NASD advises us that their rules do not prohibit this practice. They suggest that there may be SEC rules which may have a bearing on this matter.

A copy of our selling agreement is enclosed. We would appreciate your opinion of the SEC's position.

Yours very truly,
/s/ George A. Bailey, Jr.
George A. Bailey, Jr.

GABJr/jlm
enclosure

In Investment Company Act Release No. 87 (March 14, 1941), the Commission's General Counsel took the position that a broker-dealer acting solely in the capacity as agent for a purchasing or selling investor is not a "dealer" for purposes of Section 22(d), and thus could execute a transaction, assuming full disclosure of his agency capacity, at a price other than the current public offering price described in the prospectus. The Commission later confirmed that position on the meaning of "dealer" for purposes of Section 22(d) in In the Matter of Oxford Company, Inc., 21 SEC 681 (Jan. 3, 1946). See, also, *In the Matter of a Proposed Amendment to the Rules of Fair Practice of the NASD, Inc.*, 9 SEC 38, at 44, 45, Investment Company Act Release No. 118 (April 19, 1941). Accordingly, the Act does not prohibit a broker-dealer from acting as an agent with respect to a client. It is not clear to me whether or not paragraph 3 of your Dealer Agreement prohibits such broker activity, but I assume that, if it does, you would waive the prohibition.

As you may know, the Department of Justice recently sued the NASD and certain mutual fund underwriters and large NYSE broker-dealers alleging, inter alia, that provisions in their dealer agreement containing restrictions on a dealer's ability to act as an agent for a client were unlawful under the anti-trust laws. Moreover, the Commission recently concluded Hearings on Mutual Fund Distribution Systems, for the purpose of considering changes in Section 22(d)'s resale price maintenance provisions. Questions similar to yours were considered at those hearings.

In summary, no provisions of the Act or rules thereunder would prohibit the practice you describe. You have not stated what sales or other charge you would impose on the purchaser in a broker transaction. Generally, under the Securities Exchange Act of 1934, you could not charge more than a reasonable brokerage fee.

/s/ Alan Rosenblat
ALAN ROSENBLAT
Chief Counsel
Division of Investment Management Regulation
MEL

April 24, 1973

AREA CODE 215
LOcust 3-9242 *General Distributors*

GEORGE A. BAILEY & CO.
845 Land Title Bldg.
Philadelphia, Pa. 19110

SELLING GROUP AGREEMENT—SOVEREIGN INVESTORS, INC.

Gentlemen:

As general distributor and agent for Sovereign Investors, Inc. (hereinafter referred to as the "Company") we invite you to become a member of the Selling Group to distribute the shares of the Company on the following terms:

1. Orders for shares received from you and accepted by us will be at the public offering price applicable to each order as established by the then effective Prospectus of the Company. All orders are subject to acceptance by us and we reserve the right in our sole discretion to reject any order.

2. Until further notice, sales compensation will be allowed as follows:

INDIVIDUAL SALES	
Up to $10,000	7%*
$10,000 but less than $25,000	6½%*
$25,000 but less than $50,000	4¾%
$50,000 but less than $100,000	3¼%
$100,000 but less than $250,000	2.4%
$250,000 but less than $500,000	2%
$500,000 and up	1.6%

* Except for Plan sales where dealer discount is 6%.

3. As a member of the Selling Group, you agree to purchase shares only through us as principal for your own account or as agent for your customer or from your customers. Purchases through us shall be made only for the purpose of covering purchase orders already received from your customers or for your own bonafide investment. Purchasers from your customers shall be at a price not less

than the bid price quoted by us as agent for the Company at the time of such purchase. Nothing herein contained shall prevent you from selling any shares for the account of the record holder to us or to the Company at the bid price quoted by us, and charging your customer a fair commission for handling the transaction.

4. Each of your orders to us shall specify the size of each order received by you, which your order to us is intended to fill. You will maintain the current public offering price on all your resales of shares bought hereunder.

5. When acting as principal, you agree to resell the shares only to investors. You also agree not to buy shares on your own account for resale to the Company, and not to withhold placing orders from day to day in order to profit yourselves thereby. We will accept conditional orders only on the basis of a specified definite price.

6. It is further agreed that you are to act solely as purchaser through us or as agent for your customer and are not hereby employed by us or by the Company, as broker, agent or employee.

7. Payments for shares are to be made pursuant to our confirmation of your orders. Delivery instructions shall be given with or prior to payment, in the absence of which, upon receipt of payment, certificates will be issued and delivered to you at your address given below.

8. On all transactions by you involving any of the shares which are the subject of this agreement whether you are acting as principal or agent for your customer, you have and will take full responsibility for compliance by you with all applicable state and federal laws and regulations and for all communications made by you to any purchaser, and you will hold us and the company harmless from any and all claims with respect thereto and from the expense of contesting any such claims.

9. No person is authorized to make any representations concerning the Company or its shares except those contained in the effective Prospectus and any such information as may be officially designated as information supplemental to the prospectus. In purchasing shares through us you shall rely solely on the representations contained in the effective prospectus and supplemental information above mentioned.

10. Additional copies of any prospectus and any printed

information designated as supplemental to such prospectus will be supplied by us to members of the Selling Group in reasonable quantities upon request.

11. Each of us represents and agrees that each of us is (and will continue to be during the life of this agreement) a member of the National Association of Security Dealers, Inc., and we both hereby agree to abide by the Rules of Fair Practice of that Association. This agreement shall be construed to include among its terms each of the provisions required by Rule 26 of the said Rules of Fair Practice, to be set forth in a sales agreement, and each of us agrees to be bound by such provisions. If you are not eligible to be a member of the said Association because you do not maintain an office in the United States of America, you agree nonetheless to abide by the Rules of Fair Practice of the Association, particularly Rule 26, insofar as they may relate to transactions involving the shares which are the subject of this Selling Group Agreement.

12. Either party hereto may cancel this agreement by notice delivered or telegraphed to the other party, pending which this agreement shall remain in full force.

13. Any notice to you shall be duly given if mailed or telegraphed to you at your address as registered from time to time with the National Association of Security Dealers, Inc.

George A. Bailey & Co.

By ....

Accepted:

Firm Name: ....

By: ....

(Authorized Signature)

Address: ....

....

Date: ....

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

June 1, 1973

Daniel R. Hunter, Esq.
Antitrust Division
Department of Justice
Washington, D.C. 20530

Re: *United States* v. *NASD, et al.*,
Civil No. 338-73 (*D.D.C.*)

Your reference no.: TEK-BG-DRH
60-268-13

Dear Mr. Hunter:

In response to your request by letter of May 4, 1973, the Commission on June 1, 1973 authorized us to send the attached copy of what appears to be the relevant portions of a memorandum of a conference held on March 11, 1959 between the Commission staff and members of the NASD staff.

Sincerely yours,
/s/ Martin Moskowitz
MARTIN MOSKOWITZ
Assistant Director

Enclosure

GOVERNMENT EXHIBIT 6

MEMORANDUM OF CONFERENCE

BETWEEN: Wallace H. Fulton, Marc White,
Donald H. Burns and Roy Moulden
National Association of Securities Dealers, Inc.

and

Philip A. Loomis, Jr.
Robert Block and Joseph A. Keenan, Jr.
Division of Trading and Exchanges

DATE: March 11, 1959.

The meeting was held for the purpose of advising the Division of certain actions proposed to be taken by the Association concerning Association rules. . . .

. . . The last point raised concerned a proposed interpretation of Section 1 of Article III of the Rules of Fair Practice the effect of which would be to prevent a selling group dealer taking down investment trust shares from an underwriter pursuant to a selling group agreement from selling such shares to another dealer who was not party to a selling group agreement. The Investment Companies Committee proposed to prevent such transactions as being inconsistent with an orderly distribution system and conducive to the development of an over-the-counter market independent of the underwriter.

The staff objected to the proposed step on several grounds. It was pointed out to NASD representatives that the statute did not prevent such transactions, that selling group agreements could and often did bar such transactions, that it was hardly the function of the NASD to enforce selling group contract provisions (the PSI case was referred to). In the course of the discussion it became clear that the sponsor of the interpretation was the Investment Companies Committee and that most of the NASD representatives present were not in favor of the proposal. The proposal can be considered abandoned.

CC: Philip A. Loomis
Ralph S. Saul
Robert Block
Walter G. Holden
Joseph A Keenan

Block, JAKeenan, Jr./jt

voting stock and 30% of its outstanding non-voting stock. Because of their respective ownership of more than 25% of the voting stock of FMR, Messrs. Johnson 2d and Johnson 3d are each presumed to control FMR. Caleb Loring, Jr. owns 12.8% of the outstanding voting stock. No other person presently owns as much as 10% of either the voting or non-voting stock of FMR. The directors of FMR are Messrs. Johnson 2d, Johnson 3d, Loring and Byrnes.

Investment Restrictions

By the terms of its charter, the Fund is authorized to engage in the business of investing its assets in all forms of stocks, bonds and other securities and to change its investments from time to time.

It is the fundamental policy of the Fund not to:

(1) Purchase the securities of any issuer if such purchase, at the time thereof, would cause more than 5% of the value of its total assets at market value to be invested in the securities of such issuer (other than obligations of the United States Government and its instrumentalities);

(2) Purchase the securities of any issuer if such purchase, at the time thereof, would cause more than 10% of any class of securities, or of the outstanding voting securities of such issuer to be held in the Fund's portfolio;

(3) Purchase securities of other investment companies except in the open market where no commission other than the ordinary broker's commission is paid, or as part of a merger, and in no event may investments in such securities exceed 10% of the value of the total assets of the Fund. The Fund may not purchase or retain securities issued by another open-end investment company under any circumstances;

(4) It may not have more than 25% of the value of its assets invested in common stocks of companies in any one industry;

(5) Invest in the securities of companies which, including predecessors, have a record of less than three years' continuous operation, although it may invest in the securities of regulated public utilities or pipe-line companies which do not have such a record;

(6) Buy any securities or other property on margin, engage in short sales, or purchase or sell puts or calls, or combinations thereof;

(7) Invest in companies for the purpose of exercising control or management;

(8) Buy or sell real estate, commodities or commodity contracts unless acquired as a result of ownership of securities;

(9) Underwrite securities issued by others;

(10) Make loans to other persons (except by purchase of bonds and other obligations constituting part of an issue);

(11) Borrow money except as a temporary measure for extraordinary or emergency purposes, and such amounts as it does so borrow may not exceed 10% of the value of its gross assets taken at cost;

(12) Purchase or retain securities issued by an issuer if the officers and Directors of the Fund and of the Adviser, together, own beneficially more than 5% of any class of securities of such issuer.

None of the above restrictions may be changed without the vote of a majority of the outstanding shares.

Capital Stock and Non-Cumulative Voting

The Fund has only one class of securities—shares of capital stock of $1 par value—of which 75,000,000 are authorized. Those shares have non-cumulative voting rights, which means that the holders of more than 50% of the shares voting for the election of directors can elect 100% of the directors if they choose to do so, and, in such event, the holders of the remaining less than 50% of the shares voting for the election of directors will not be able to elect any person or persons to the board of directors.

Fractional shares may be issued and when issued have the same rights proportionately as full shares. Currently, such fractional shares are issued only in connection with the Voluntary Accumulation and Systematic Withdrawal Plans as described on page 8. Each full share has one vote, and when issued is fully-paid and non-assessable. The shares are transferable by endorsement or stock power in the customary manner, but the Fund is not bound to recognize any transfer until it is recorded on the books of the Fund. Each share is entitled to share equally in any dividends or distributions declared by the Board of Directors. In the event of liquidation of the Fund, the holders of shares are entitled to all assets remaining for distribution after satisfaction of all outstanding liabilities and are entitled to share therein in proportion to the number of shares held. No shares carry any conversion, subscription or other pre-emptive rights except the right to require redemption thereof by the Fund and the privilege of exchanging shares for shares of certain of the other Funds in the Fidelity Group of Funds, as described on pages 9–10.

Sale of Shares

Investors may buy shares at the public offering price equal to the net asset value per share at the time of purchase plus a sales charge, which is a perce[illegible] and

GOVERNMENT EXHIBIT 7

History and Capitalization

The Fund is a Massachusetts corporation carrying on the business of an earlier Delaware corporation formed in 1932. Shareholders are entitled to dividends when and as declared by the Board of Directors and to participate equally in any liquidation or dissolution of the Fund. Shares when issued will be fully paid and non-assessable and fully transferable. Shares have no pre-emptive, subscription or conversion rights. The authorized capital stock of the Fund consists of $1 par value shares of one class having equal voting rights having one vote per share. These shares have non-cumulative voting rights which means that the holders of more than 50% of the shares voting for the election of Directors can elect 100% of the Directors if they choose to do so, and, in such event, the holders of the remaining less than 50% of the shares voting for the election of Directors will not be able to elect any person or persons to the Board of Directors.

Investment Objective and Policy

The objective of Massachusetts Investors Growth Stock Fund is to provide long-term growth of principal and future income rather than current income return. To achieve this objective it is the policy of the Fund to keep its assets invested, except for working cash balances, in the common stocks, or securities convertible into common stocks, of companies believed by the management to possess better than average prospects for long-term growth, and this policy may not be changed without a vote of shareholders. Emphasis is placed on the selection of progressive, well-managed companies.

Since the shares of the Fund represent an investment in common stocks, shareholders should understand that the price of the Fund's shares will go up or down with changes in the market value of the stocks held by the Fund. Moreover any dividends paid by the Fund will increase or decrease in relation to the amount of dividends received from these investments. There is no guarantee that the objective of the Fund will be realized and its name does not imply an assurance that an investor's capital will increase.

Investment Powers and Restrictions

The Fund may not purchase the securities of any issuer if such purchase would cause more than 5% of its total assets taken at market value to be invested in securities of such issuer, other than United States Government obligations. The Fund may not purchase the securities of any issuer if such purchase would cause more than 10% of any class of securities of such issuer to be held in the portfolio and may not invest more than 5% of its assets in the securities of companies which, including predecessors, have not been in continuous operation for at least three years. The Fund may not purchase securities issued by investment companies except in the open market or in connection with a plan of consolidation or merger, nor may it purchase or retain securities of a company if one or more of the Fund's management owns ½% each and such persons own collectively more than 5% of the company's shares. The above restrictions may not be changed without a vote of the shareholders.

The Fund purchases securities primarily for investment, rather than with a view to trading profits. While the rate of portfolio turnover is not a limiting factor when management deems changes appropriate, it is expected that the Fund's annual portfolio turnover rate generally will not exceed 50% in a particular year. The Fund's portfolio turnover rates for the past three years are set forth on page 7. The Fund owns foreign securities and may from time to time purchase such securities even though an interest equalization tax, presently a maximum of 11¼%, may be incurred. Such tax would increase the cost of such securities and correspondingly reduce the return on them.

It is not the policy to invest for the purpose of exercising control or management. It is not the policy to engage in underwriting securities (except insofar as the Fund may technically be deemed an underwriter in selling a portfolio security under circumstances which may require registration of the same under the Securities Act of 1933), to concentrate more than 25% of the assets (at market value at the time of each investment) in any one industry, to purchase or sell real estate, commodities or commodity contracts. No margin transactions or short sales are permitted. The Fund may borrow money up to 10%, and may pledge up to 15%, of its gross assets at cost subject to a 300% asset coverage requirement (but only temporarily for extraordinary or emergency purposes). The Fund may make call or six-month secured loans through notebrokers or banks. The restrictions in this paragraph may not be changed without a vote of shareholders.

Services for Shareholders-Lifetime Investing Account

Every shareholder has a Lifetime Investing Account whereby he will receive after each share transaction a statement showing the cumulative activity in his account since the beginning of the year. At the end of each year he will receive a complete annual statement of share transactions as well as income tax information regarding dividends and capital gain distributions. Share certificates will not be issued unless requested. (Certificates for fractional shares are not issued in any case.)

THE PRICE TO THE PUBLIC FOR SHARES OFFERED BY THIS PROSPECTUS VARIES WITH THE FLUCTUATIONS IN THE MARKET VALUE OF SECURITIES OWNED BY THE FUND. IT IS COMPUTED AT LEAST ONCE DAILY AS OF THE CLOSE OF THE NEW YORK STOCK EXCHANGE, ON EACH DAY THE EXCHANGE IS OPEN FOR TRADING AND IS THE NET ASSET VALUE PLUS A SALES CHARGE EQUAL TO 8.5% (MAXIMUM) OF THE OFFERING PRICE, SCALED DOWN TO 1¼% (MINIMUM) DEPE[illegible] PURCHASE AS MORE FULLY DESCRIBED ON PAGE 3.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND [illegible] SION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF [illegible] ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

GOVERNMENT EXHIBIT

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to its stockholders. Such qualification would not, of course, involve governmental supervision of management or investment practices or policies.

Under the Internal Revenue Code, a regulated investment company is relieved of Federal income tax on its net ordinary income to the extent such income is distributed to its stockholders. Such net ordinary income distributions are taxable to the recipient stockholders as ordinary income and are eligible, in the case of individual stockholders, for the $100 dividends exclusion and, in the case of corporate stockholders, for the 85% dividends received deduction, subject to proportionate reduction of the amount eligible for exclusion or deduction if the aggregate dividends received by the Company from domestic corporations in any year are less than 75% of its gross income exclusive of capital gains. The excess of net long-term capital gains over net short-term capital losses realized and distributed by the Company to its stockholders as capital gains distributions will not be taxable to the Company but will be taxable to the stockholders as long-term capital gains, irrespective of the length of time a stockholder may have held his stock. Capital gains distributions are not eligible for the exclusion or the deduction referred to above. Distributions of gains realized on the sale of securities will be taxable to stockholders as stated above, even in those situations where the distribution will reduce the net asset value of the stockholder's interest to below the amount paid for his stock. Any dividend or distribution received by a stockholder on shares of the Company shortly after the purchase of such shares by him will have the effect of reducing the net asset value of such shares by the amount of such dividend or distribution. Furthermore, such dividend or distribution, although in effect a return of capital, is subject to applicable taxes to the extent that the investor is subject to such taxes. Stockholders will be advised annually as to the tax status of dividends and capital gains distributions.

On September 30, 1972 the Company's net assets included net unrealized appreciation of securities of $829,835, equivalent to $3.83 per share and 19.9% of net asset value.

For Federal income tax purposes, when put and call options which the Company has written separately expire unexercised, the premiums received by the Company become ordinary income at the time of expiration. Puts and calls written as straddles give rise to short-term capital gains at the time they expire unexercised. When a call is exercised, the selling price of the stock is increased by the amount of the premium, and the gain or loss on the sale of stock becomes long-term or short-term, depending on the holding period of the stock. When a put is exercised, the Company reduces the cost price of the stock by the amount of premium received.

DESCRIPTION OF COMMON STOCK

The authorized capital stock of the Company consists solely of 10,000,000 shares of Common Stock having a par value of $.002 per share. Each of the Company's shares has equal dividend, distribution, liquidation and voting rights. There are no conversion or pre-emptive rights in connection with any shares of the Company. All shares of the Company when issued will be fully paid and non-assessable. The rights of the holders of shares of Common Stock may not be modified except by vote of the holders of a majority of the outstanding shares.

A 50 for 1 split of the shares of the Company's Common Stock, a related increase of the Company's authorized capital stock from 200,000 to 10,000,000 shares of Common Stock, and a related decrease of the par value of such shares from $.10 to $.002 became effective February 5, 1971, having been approved by the Board of Directors and by the stockholders of the Company at the annual meeting on February 4, 1971.

To assure that any proposed transferee is aware of the investment objective and policies of the Company, shares are transferable only with the consent of the Board of Directors.

The Certificate of Incorporation of the Company gives the Company the right to purchase for cash (i) the shares of the Common Stock evidenced by any stock certificate presented for transfer and

PAINE, WEBBER, JACKSON & CURTIS

NEW YORK OFFICE MEMORANDUM 438

TO: ALL PARTNERS, REGIONAL PARTNERS, BRANCH OFFICE MANAGERS AND STOCKBROKERS

FROM: A. L. MEENTEM..HER
GEORGE WASHBURN

SUBJECT: MUTUAL FUND SELLING PRACTICES

The policy of the firm relating to the handling of mutual fund orders for customers has always been aimed at protecting the interests of the customer. For many years the written policy sought to discourage clients from switching funds and liquidating funds to make money available for other investments.

As a result of recent developments, it has become necessary to review our policy and to take the following additional steps to strengthen and augment it:

1. Each office must keep a separate record by customer and family group for all mutual fund transactions. This record must include the customer's name and account number, account of related persons, the stockbroker's name, customer's approximate age and details of each transaction. The form below should be adopted for this purpose. A supply of this form will be sent to each office.

MUTUAL FUND TRADE CONTROL RECORD

Account No.____________________

Customer Name____________________

Broker ____________________

Name of Related Accounts____________________

Customer's Approximate Age____________________

Trade Date	Bot* Sold	No. Shares	Fund Name	Price Per Share	Gross Money	Remarks**

*If liquidation, report must be sent to New York; if switch, has switch letter been received from customer and sent to New York.

**Under remarks, indicate signed letter of intention (date and amount), right of accumulation, discounts, etc.

5.03.4 Letters of Intention

On all mutual funds purchases, stockbrokers are required to explain carefully to the customer the various discount privileges available through a letter of intention or otherwise, and to record on the customer's mutual fund record a notation that such has been done. When mailing the prospectus and confirmation of each mutual fund purchase, a brief explanation of the normal discount privileges offered by most funds must be included.

5.03.5 Additional Sales Charges on Multiple Fund Purchases

Stockbrokers are required to explain to customers the additional sales charges involved in the purchase of funds of different sponsors over the purchase of a single fund or the ''sister'' funds of the same sponsor. The branch manager is responsible for reviewing and approving each multiple fund situation. He should initial a record as evidence of such review.

5.03. Absence of Selling Agreement

Retail orders for fund shares witn whose management the firm does not have selling agreements may be filled if the shares can be purchased in the open market from an NASD member. The retail price charged must be equal to that charged by the sponsor.

GOVERNMENT EXHIBIT 11

MUTUAL FUNDS MANUAL

The contents of this Manual are confidential and are not to be distributed or released to anyone outside of Merrill Lynch, Pierce, Fenner and Smith Inc.

Operations Division
Merrill Lynch, Pierce, Fenner and Smith Inc.
June 30, 1970

1

GLOSSARY ON MUTUAL FUNDS

1. An *Accumulation Plan* is a plan by which an investor may make a regular purchase in a mutual fund in any share or dollar amount as long as the amount exceeds the minimum requirement outlined in the mutual fund prospectus. Income resulting from a customer's holdings in a mutual fund is called dividend and capital gains distribution and such distributions are usually reinvested automatically.
2. Any mutual fund with which Merrill Lynch has an agreement contract and for whom Merrill Lynch acts as dealer is called an *Agreement Fund.*
3. *Representative List* mutual funds are those which Merrill Lynch recommends for purchase at a given time.
4. A *Closed End Fund* is a mutual fund which has a specified number of shares authorized for sale to stockholders. Additional shares cannot be issued without the approval of the stockholders.
5. An *Open End Mutual Fund* is one that continuously issues new shares for public sale and agrees to redeem its shares at asset value on any day the New York Stock Exchange is open.
6. A *Custodian Bank* holds securities and cash owned by a mutual fund and frequently acts as the mutual fund's transfer agent.
7. The *Grey Market* is a term describing unlisted mutual funds with which Merrill Lynch does *not* have an agreement. For Grey Market funds Merrill Lynch makes no transactions directly with the fund but through a

dealer without a selling group willing to inventory fund shares from both buyers and sellers.

8. Mutual Fund shares are considered *Issued* when they are registered in the client's name and physically shipped to the customer. (A "DLD" entry appears on the customer's statement at the time the securities are shipped to the customer).
9. A *Letter of Intent* (LOI) is a written agreement by which a client *agrees to purchase* a specified dollar amount of a mutual fund within a 13 month period in order to receive a reduced commission rate for the total purchases made in the period. The total amount to be invested must equal the commission breakpoints indicated in the mutual fund prospectus. When shares for an LOI are issued to the customer, a percentage of the shares are held in escrow by the custodian bank until the LOI is completed. If the LOI is not completed in the 13 month period, the escrow shares necessary to meet the full commission charge on the purchases are liquidated. An LOI *may be back dated* to include purchases made in the last 90 days. (The LOI *expires* 13 months from the date to which it is back dated). A custodian bank statement is not printed for a new account buying under an LOI until the LOI form itself is physically received and processed by the fund.

iii. Places all mutual funds securities and their Code 80 in a special mutual fund envelope provided to all offices and mails to:

MERRILL LYNCH, PIERCE, FENNER
& SMITH INC.
Mutual Funds Department
Post Office Box 678—Wall Street Station
New York, New York 10005

NOTE: Do not mail the Code 80 security report and securities to the Registered Mail Section in New York.

(c) Staples the office copy of the order to the local billing. ***Checks office 1028 to see that transactions have been properly processed.***

III. *PURCHASE ORDERS AND SALES: "GREY MARKET" MUTUAL FUNDS*

Where there is *no* Grey Market for the fund shares and the Grey Market shares are long in the customer's account, the shares may be redeemed through a regular securities order request for redemption, directed to the Mutual Funds Department QP RDP as they may be issued to the customer so that he may send them directly to the Mutual Fund for redemption. It is important to know that a confirmation that the order was received by Exchange *does not* constitute an execution price as of that day. The price is established by the fund on the day the shares are physically delivered to the fund.

Purchase and Sale orders on funds for which Merrill Lynch *does not have signed agreements* are executed in the so called "grey market." BEFORE ACCEPTING AN ORDER FROM A CUSTOMER THE A/E MUST WIRE QP.GVS, GIVING SIZE OF ORDER TO DETERMINE AVAILABILITY OF A GREY MARKET. AVAILABILITY OF GREY MARKETS MAY VARY FROM DAY TO DAY. "Grey Market" mutual funds orders will be entered via the Merrill Lynch Mutual Funds Order Form Code 282. The procedures for handling and processing purchase and sale orders of "grey market" mutual funds are the same as those outlined above for the "agreement" funds (Section I and II above) except that there are no plan arrangements (ie., L.O.I. SWP, etc) or automatic re-investment of dividends and capital gains payments.

On "grey market" sales the offices must have possession of the certificate(s) at the time the sale order is entered and the certificate numbers must be included on the order—unless the customer's Merrill Lynch account is long the security being sold. The A/E must determine availability of grey market by wiring QP.GVS.

Offices should not enter sell orders for "grey market" funds if Merrill Lynch does not have possession of the certificates. All mutual fund certificates received in the office will be posted to the special Security Report Code 80 for Mutual Funds (and included in the special Mutual Funds Department envelope when shipped to New York).

IV. *UNLISTED MUTUAL FUNDS TRANSFER PROCEDURES*

Generally, transfers of unlisted Mutual Funds require special instructions and handling. The procedures vary for 'agreement' and 'grey market' funds, and for 'issued' or 'unissued' securities. On purchases of any unlisted mutual fund, the initial purchase order will include the necessary transfer instructions or instructions on securities to be held by the custodian.

For all purchases, the Mutual Funds Department prepares the necessary transfer instructions. Office prepares required transfer instructions on all other *non-order transfers,* as indicated below.

A. *Transfers to be made with purchase of "agreement" Mutual Fund*

The offices will wire with purchase orders the necessary information to effect registration (transfer) and delivery to customers, or to have Fund's Custodian hold such securities for customer in 'unissued' account. If the necessary information does not accompany each purchase order, the office will be challenged and the *execution of the purchase may be delayed.*

B. *Transfers to be made with purchase of "No Load" and Non-Agreement Mutual Fund (Grey Market)*

Purchases of Funds with which Merrill Lynch *does not have a signed agreement* (grey market) must have the securities transferred and shipped to the customer. Merrill Lynch can not hold such securities in the customer's account. Since Merrill Lynch does not have any agreement with these funds, arrangements cannot be made to have the fund's custodian hold the security for the customers. Offices must wire with the purchase order the necessary registration and delivery instructions as provided on the Mutual Funds Order Form. If the necessary transfer information does not accompany the purchase order, the office will be challenged and the execution may be delayed.

C. *Transfers of "agreement" Mutual Funds where the customer or Merrill Lynch has possession of securities*

If a customer or Merrill Lynch holds securities for a mutual fund with which Merrill Lynch has an agreement, transfers of such securities to a specific name and address can be made provided the customer furnishes:

(a) Name, address and social security number of registrant.

(b) Name and address to which securities are to be mailed if different than registrant's.

The office will prepare a Mutual Fund Transfer Instruction Code 283 for the transfer. The Code 283 Instructions will be sent (with certificates if customer delivers certificates to the office) to the Mutual Funds Department in the Special Mutual Funds envelope.

Government Exhibit 12

cc WFS, EFH, HF, JR., TAB, KV, DS, HF, JR., C. MacK, J. McG, HH, RC, (and all girls who handle teletype) EP, DTS, Jr., AF, HIS, NYC, MLB, RP, RJA, CHIC., JAC, Jr., JAC, 3rd, TW, LA.

MEMORANDUM

FROM: Henry T. Vance

TO: All Partners
Wholesale Men
Branch Offices

October 4th, 1950.

This memorandum is being written merely to confirm the understanding we reached at the meeting of our partners and wholesale representatives here last week, to the effect that we will, in the future, admit to membership in our various Selling Groups, upon request, any dealer firm which is a member of The New York Stock Exchange. As you know, this decision to qualify automatically a dealer for membership in our Selling Group, who has met the standards of The New York Stock Exchange, is somewhat of a departure from past practice insofar as our organization is concerned, and, accordingly, I thought it might be well for me to review here several of the factors which led us unanimously to agree to take such action.

The investment company business has grown substantially in recent years, not only in total dollar volume, but in general public recognition and acceptance. It now seems to be fairly generally agreed among government officials, economists, financial writers, and executives of important financial institutions, that the open-end or mutual investment company can occupy an important place, on an institutional basis, in solving the investment problems of most investors along with government bonds, savings banks, life insurance, home mortgage institutions, etc. As the basis of service of the mutual investment companies has broadened, it has seemed to us essential that we maintain as many outlets for the sale of our funds as is consistent with prudent business policy, in order to keep open the channels through which investors' funds may flow into the shares of our companies.

That these channels have increased in recent years is, of course, a fact of which you are all intimately aware, but

to illustrate the point, I might add that when I came to Boston in 1936, we had less than 300 dealers in our Selling Group, whereas today the number of dealers is approximately 1,050. If we add branch offices—which we properly should do—our total number of outlets today exceeds 3,500.

In every instance of which I am aware, the increase in our Selling Group membership in each community has added materially to the volume of other local dealers—in other words, the increase in the number of dealers enthusiastically discussing the merits of our investment companies has been advantageous to all dealers in the Group. We have, of course, made every effort to limit the extension of Selling Group membership to only those dealers who have had a good local reputation in the investment business. It has seemed to us, however, that any firm which has met the requirements of The New York Stock Exchange for membership should without question measure up to the standards of our own requirements for membership in our Selling Group, and accordingly, we have agreed that we will be willing from this point on to accept any New York Stock Exchange member into our Group without further check by you either with local dealers or with the home office.

Memorandum

From: Henry Vance

To: All Partners
Wholesale Men
Branch offices

October 4, 1950.

There are other questions to be taken into consideration in connection with the expansion of our Selling Group. One is that it is quite important to the investment company industry as a whole to maintain amicable and close-working arrangements with the New York Stock Exchange and its members. We can all recall that during the early stages of our development, many of the New York Stock Exchange houses looked upon the investment company as a possible threat to their business. This was a natural reaction, but one which could have been very damaging if it had not been arrested in time. The experience of Stock Exchange houses who were active in the sale of investment company shares, of course, helped provide part of the answer. Just as importantly it should be noted that the Exchange itself studied many of the seeming controversial aspects of our development, jointly with a Committee of the National Association of Investment Companies. As a result, I believe that we have an opportunity to work hand in hand with the Exchange, and it is well to recognize that the Exchange, which could have been a very troublesome opponent, now can well be of great help as the years go on.

There are other factors which tend towards making it important for us to consider the enlarging of our Selling Group. Some of you will recall the effort that has been made on the part of a National Association of Investment Companies' Committee to persuade the Securities and Exchange Commission to require the delivery of prospectuses in connection with all transactions at retail whether made by a dealer who is a member of a selling group or one who is buying stock in the street. This has raised questions on the part of the Securities and Exchange Commission Commissioners as to underwriters' policy with respect to including dealer firms in their selling groups. This situation has not as yet come to a head, but I am convinced that if we are to achieve our objectives we must show a reasonable willingness to open our Group to additional responsible dealers.

We are all apt to forget too the vital importance which price maintenance—guaranteed to us by Section 22D of the Investment Company Act—has played in our sales growth during the last ten years. This is a provision which can be of importance to a business operating with redeemable shares. Once a dealer is admitted to a Selling Group, he puts through his order as a principal at the official offering price. On the other hand, when a responsible dealer is prevented from joining our Group, he naturally will endeavor to find a way of doing business as a broker on an agency basis at a price below the official offering price, thus competing on a basis which is to the disadvantage of our regular dealers. It is important—it seems to us—to eliminate as much of this kind of business as we can, and to knit together all of the responsible investment dealers in this country in a co-ordinated sales campaign which will cut down competitive street markets and will lessen any pressure for a change in Section 22D of the Act.

I could add additional reasons for the decision which was arrived at last week, but I am sure that these will be sufficient to convince any thinking dealer that our policy with respect to including any members of the New York Stock Exchange in our Group is one which is constructive and necessary in the sound and proper development of the business of our dealers and ourselves.

Sincerely,
HTV

htv/nwh

GOVERNMENT EXHIBIT 13

THE CROSBY CORPORATION
Office Memo

To Harold A. Hobson, Jr. Date October 30, 1970
From Alan C. F. Leggett Re:

On July 24, 1970 you wrote a memo to Bill Kallenberg indicating that some dealers when taking in liquidations will not redeem through Crosby, but rather will hold in their house account and reregister to a purchaser. A week's sampling of transfers at the State Street Bank revealed only one item which would appear to fall into this category. However, a review of the transfers at the Shawmut Bank for the period 9/15-9/30 indicated that the bulk of the transfers at the Shawmut appear to be transactions of this nature. For purposes of this investigation, we assumed that any transfer from one registration to an apparently unrelated registration was not what we would consider to be a legitimate transfer. Therefore, it does appear that the condition which you have described does exist.

Our counsel agrees with me that the language of our sales agreement does not prohibit a dealer purchasing at net asset value from one investor and reselling to another investor at the public offering price. In summation, it was counsel's opinion that we should not revise the sales agreement to extend any restrictions on the dealer, since to do so would cause serious questions under the anti-trust laws.

The answer, then, to your original inquiry is that yes, the condition does exist, but that it is not in violation of our sales agreement. There is some loss of revenue to Crosby because of this condition, but we will have to live with it. In any case, thanks for bringing this to our attention.

ACFL/cmb

COLONIAL MANAGEMENT ASSOCIATES
75 FEDERAL STREET
BOSTON 10, MASSACHUSETTS

December 22, 1958

Mr. Robert L. Cody
Vice President and Secretary
North American Securities Company
615 Russ Building
San Francisco 4, California

re: *Purchase of Investment Company Shares from Underwriters by Selling Group Members and Subsequent Resale to Non-Selling Group Members*

Dear Bob:

Ray Moulden's memorandum of December 17 asks for the answers to certain specific questions relative to the above matter. My answers are as follows:

(a) No.

However much we would like 26(f)(2) to cover such a practice, all this section says is that NASD members may purchase from underwriters if they do so for the purpose of covering orders on hand or for investment. The fact that the orders come from other non-selling group dealers and they choose to sell to them at less than the public asking price is just not within the scope of 26(f)(2). This particular problem can be handled by appropriate language in the selling group agreements of the members.

(b) No.

See my answer to (a) above. The fact that there is or is not a discount would not seem to make any difference.

(c)(1) No.

All that 26(a) says is that securities can be sold at a discount by NASD members only to NASD members.

GOVERNMENT EXHIBIT 14

December 22, 1958

Mr. Robert L. Cody
Vice President and Secretary—2.

(c)(2) No.

However, I suppose that if the dealer violates an agreement which he has made with another member, he may be acting other than in accordance with the high standards of commercial honor which the Association was formed to promote and that this might furnish the basis for some kind of disciplinary proceeding against him, although query whether the Association should become involved in enforcing private agreements.

I recognize that the purchase of investment company shares with subsequent resale to other NASD members at less than the public offering price does encourage the street market and that unfavorably affects the distribution of investment company securities but it does not seem to me that these practices are within the scope of 26(f)(2) or 26(c).

I believe that most selling group agreements can be amended by the underwriter at will and I would suggest that a more practical way to deal with this situation is to suggest to underwriters that this area be covered by a properly drawn selling group agreement.

Sincerely,
(sgd.)
Franklin R. Johnson

Excerpts from minutes of
I. C. C. meeting
10/24/58

Purchase of Investment Company Shares from Underwriters by Selling Group Members and Subsequent Re-Sale to Non-Selling Group Members: The Committee considered whether the term "purchase orders," as set forth in the last line of Section 26(f)(2) of Article III of the Rules of Fair Practice, is limited to orders from members of the public. The question was posed as part of a general discussion of practices of some selling group members which, unbeknownst to the underwriters, take down shares at a discount and re-sell them to members who do not have a selling group agreement at a price sufficiently below the public offering price to permit both the selling group member and the non-selling group member to earn a profit on the transactions.

Consideration was also given to the significance of Section 26(f)(2) in the situation just described in the light of Section 26(c), which states in part that no member may purchase shares at a discount unless a sales agreement is in effect between the underwriter and the purchasing dealer. The Committee took the position that interpreting Section 26(f)(2) to permit the purchase of shares from an underwriter by a selling group member for re-sale to a member that does not have a selling group agreement with the underwriter (regardless of the question of discounts) is an encouragement of the street market that could unfavorably affect the orderly distribution system that Section 22(d) of the Investment Company Act and Section 26 of the NASD Rules are designed to promote.

When the discount element enters the picture, it was further argued, the encouragement of the street market is compounded, and then the non-selling group members are enabled to acquire shares at a discount and profitably re-sell them to other members or to the public. Further still, such transactions have the effect of making Section 26(c) meaningless. For the actual result is that the non-selling group member is enabled to acquire shares from the underwriter (through the selling group member) at a discount from the public offering price without a selling group agreement being in effect between them.

GOVERNMENT EXHIBIT 14A

A further question in this area is whether the selling group member who takes down shares at a discount from the underwriter and re-sells at a discount to a non-selling group member is violating his selling group agreement. Most selling group agreements (but not all) state in effect that the contracting dealer may not buy shares from the underwriter at a discount except to fill orders from members of the public (i.e., not from other dealers). Whether the violation of a selling group agreement between NASD member underwriters and NASD member dealers that is entered into under the requirements of Section 26(c) for the purpose of promoting the orderly distribution of open-end investment company shares, as provided for in Section 22(d) of the Investment Company Act, is actionable under NASD rules as a violation of those rules is a question that can be answered only by the Association's Board of Governors with the advice of counsel, the Committee held.

However, whatever the Board might decide as to whether a violation of a selling group agreement involving investment company shares is actionable, the Committee suggested that a more basic approach to the overall problem of the street market might well be through Section 26(f)(2). In the opinion of the Committee, the meaning of the term "purchase orders," in the last line of Section 26(f)(2), should be interpreted as meaning orders from the public only. The Committee further felt that there should be a recommendation suggesting that the Board so interpret Section 26(f)(2) as an integral element in the promotion of the orderly distribution of investment company shares.

The effect of such an interpretation, obviously, would be to bar transactions between selling group members and non-selling group members in shares taken down from an investment company underwriter.

The Secretary was instructed to discuss the question of the meaning of the term "purchase orders," as set forth in the last line of Section 26(f)(2), with Henry Vance. Mr. Vance was a leading participant in writing Section 26(f)(2) so that it would satisfy Section 22(d) of the 1940 Act, as the means through which NASD would carry out the statute's directive for the maintainance of an orderly distribution system.

(Subsequently, in a discussion with Mr. Vance, the Secretary developed these points:

1. Section 26(f)(2) was aimed at two things: (a) to prevent dealers from taking down shares at a time of market rise and holding them for sale to customers at a profit and (b) to circumscribe the street market which was endangering the orderly distribution system.
2. Section 26(f)(2) has had the effect of discouraging the sale of shares between one dealer and another, and thus has helped circumscribe the street market.)

GOVERNMENT EXHIBIT 15

RE: *Purchase of investment company shares from underwriters by selling group members and subsequent resale to non-selling group members*

Section 26(c) of Article III of the Rules of Fair Practice reads, in part, as follows:

> ". . . . No member who is underwriter of the securities of an open-end investment company shall sell any such security to any dealer or broker at any price other than a public offering price unless (1) such dealer or broker is a member and (2) at the time of the sale a sales agreement is in effect between the parties."

Section 26(f)(2) reads as follows:

> "No member shall purchase the securities of any open-end investment company of which it is the underwriter from such company except for the purpose of covering purchase orders already received and no member shall purchase such securities from the underwriter other than for investment except for the purpose of covering purchase orders already received."

The Investment Companies Committee has given much thought to the matter of transactions of the type noted above in relation to Section 26(f)(2) and Section 26(c) of Article III of the Rules of Fair Practice. Recognizing the fact that one of the principal purposes of Section 26 and of Section 22 of the Investment Company Act of 1940 was to encourage and maintain an orderly distribution system for the shares of open-end investment companies, the Committee is convinced that transactions in the shares of investment companies between selling group members and non-

selling group members is a deterrent to and unfavorably affects the orderly distribution system.

It seems reasonable to assume that Section 26(f)(2) was intended to mean that a dealer could purchase shares from an underwriter only for investment or to cover purchase orders already received *from members of the public,* as distinct from other dealers. Otherwise, there appears to be no reason for requiring a sales agreement in Section 26(c), because by simply inserting a selling group member between the underwriter and the non-selling group member all of the sales agreement requirements of Section 26(c), which are directed toward an orderly distribution of shares, could be avoided.

The Investment Companies Committee therefore recommends that the Board of Governors adopt the position that for the future Section 26(f)(2) be interpreted as though the words "from members of the public" were added to the end of the paragraph. This would have the effect of requiring dealers to take down shares from investment company underwriters (other than for investment) only to fill purchase orders already received from members of the public.

GOVERNMENT EXHIBIT 16

Excerpts from minutes of
I. C. C. meeting
2/27/59

2. *Interpretation of Section 26(f)(2):* The Chairman reviewed the discussion on this matter at the January Board meeting, noting that the Board had considered the memorandum to the Executive Director from the Secretary, indicating that (based on a questionnaire) the Committee favored an interpretation of Section 26(f)(2) as though the paragraph prohibited dealers taking down shares from underwriters except for investment or to fill orders from members of the public. Since that memorandum did not contain recommended language, the Board asked the Committee to reconsider the matter and if it was still of the same opinion, to adopt specific language which could be discussed with the SEC and submitted to the Board for adoption at the May meeting. During the discussion that followed, Mr. Cody made it clear that the Board of Governors does not want to be in a position of enforcing selling group agreements, and the Committee agreed that as a matter of policy it would encourage underwriters generally to amend their selling group agreements to limit sales to dealers for investment or to fill orders from members of the public. After some discussion, the Committee unanimously adopted the draft of a memorandum which had been prepared by the Secretary.

(The proposed interpretation was discussed with the Staff of the Trading and Exchanges Division of the SEC in March, together with the Board's interpretation barring special deals. The SEC officials could find nothing in the statutes or legislative history to support the proposed interpretation. Moreover, they held that its effect would be to require the NASD to enforce selling group agreements which, they emphasized, had been barred by the Commission decision in the Public Services of Indiana case some years ago, and that if the Board insisted on formally filing the proposed interpretation, the Division would be forced to oppose it at the Commission table. The Staff also said that it felt that investment company underwriters should amend their selling group agreements to cover the point involved, if they so desire, and enforce the contracts themselves. This adverse Commis-

sion position will, of course, be reported to the Board in May, and it seems virtually certain that the Board will not wish to pursue the matter further. The Staff did accept the Board's special deals interpretation, with certain language changes which were suggested for clarity and did not alter the substance. This latter version has been resubmitted to the Board for mail vote, and reapproved with certain perfecting amendments suggested by Mr. Cody. It has been sent to underwriters and will be sent to the membership shortly.)

Government Exhibit 17

Excerpts from text of report
of I. C. C. to Board
5/11-13/59

Interpretation of Section 26(f)(2)

At this meeting, the Committee reviewed the proposed interpretation of Section 26(f)(2) of the Rules of Fair Practice discussed at the January Board meeting, which interpretation would prohibit dealers from taking down investment company shares from underwriters except for investment or to fill orders from members of the public. As requested by the Board, the Committee considered specific language for discussion with the SEC by the Executive Director which, if not disapproved by the Commission Staff, would be presented to the Board for adoption at the May meeting. In discussing this matter, it was made clear to the Committee that the Board of Governors has no wish to be in the position of enforcing selling group agreements. The Committee, in turn, has agreed that as a matter of policy it will use its best efforts to encourage underwriters to amend their selling group agreements so that sales to dealers are limited to purchases for investment or to fill orders from members of the public, and to enforce these agreements by cancelling contracts with firms that may not live up to the undertakings of such agreements.

The Committee did adopt a memorandum recommending a Board interpretation in this area which, as the Executive Director has already advised you, was received adversely by the Trading and Exchanges Division of the Commission. In view of this development, the Committee does not feel it would serve a useful purpose to present the proposed interpretation to the Board of Governors. It will, however, continue to encourage other underwriters to amend and enforce their selling group agreements as outlined above. It is suggested that the Executive Director send a letter to underwriters and distributors of investment company shares suggesting that they make any necessary revision of their selling group agreements to make it clear that sales may be made only for the purpose of filling orders from members of the public or for investment and suggesting the importance of self-enforcement of selling group agreements

by the underwriters. Such a letter was drafted by the Investment Companies Committee, signed by the Executive Director, sent to all member underwriters and distributors of investment company shares, and is attached as an exhibit to this report.)

GOVERNMENT EXHIBIT 18

ALEXANDER YEARLEY, IV
Chairman
DONALD L. PATTERSON
Vice Chairman
ALLEN J. NIX
Vice Chairman
ERNEST W. BORKLAND, JR.
Treasurer
WALLACE H. FULTON
Executive Director

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1707 H STREET N. W. WASHINGTON 6, D. C.

TO UNDERWRITERS AND DISTRIBUTORS OF INVESTMENT COMPANY SHARES

The Board of Governors believes that the spirit, if not the intent, of Section 26(c) and Section 26(f)(2) of Article III of the Rules of Fair Practice is not being observed when dealers are permitted to take down shares from investment company underwriters with whom they have selling group agreements to fill orders—at a discount from the public offering price—from other dealers who are not parties to the same selling group agreement.

This practice permits dealers who are not parties to selling group agreements to obtain investment company shares indirectly and at a discount from the underwriters of such shares, thus bypassing the intent of Section 26(c).

This situation may be corrected by underwriters and distributors through amendments to selling group agreements to the effect that parties to the agreement may take down shares at a discount *only* to fill orders in hand *from members of the public* (or through agreements limiting such transactions to orders from "customers," as defined in Section 1(f) of Article II of the Rules of Fair Practice) * or for bona fide investment. Strict enforcement of the terms of selling group agreements, of course, will also serve to remedy this situation.

By order of the Board of Governors
/s/ Wallace H. Fulton
WALLACE H. FULTON
Executive Director

June 22, 1959

(* Section 1(f) of Article II of the Rules of Fair Practice reads as follows: "The term 'customer' shall not include a broker or dealer.")

Board of Governors

GLENN E. ANDERSON	Raleigh
ANDREW M. BAIRD	Chicago
CURTIS H. BINGHAM	Los Angeles
ERNEST W. BORKLAND, JR.	New York
FRANCIS M. BROOKE, JR.	Philadelphia
WILLIAM H. CLAPLIN, III	Boston
ROBERT L. CODY	San Francisco
JAMES G. DERN	Chicago
J. GORDON HILL	Detroit
JAMES F. JACQUES	Dallas
GRAHAM JONES	Hartford
RICHARD LAWSON	San Francisco
GLENN L. MILBURN	Wichita
ALLEN J. NIX	New York
BLANCKE NOYES	New York
GEORGE H. NUSLOCH	New Orleans
DONALD L. PATTERSON	Denver
RALPH C. SHEETS	New York
CLAUDE F. TUREEN	Cleveland
SAMUEL S. WHITTEMORE	Spokane
ALEXANDER YEARLEY, IV	Atlanta

Excerpts from minutes of
I. C. C. meeting
6/16/59

A. The Chairman's report on the last meeting of the Board of Governors

1. Investment Companies report to the meeting was generally to report the status of pending matters and did not include any recommendations to the Board involving crucial matters.

2. Mr. Cody mentioned that one ICC recommendation had been changed (at the February meeting the Committee adopted the policy that it would use its best efforts to have sales agreements amended and enforced by member underwriters in order to prevent the sale, by selling group members of IC shares to non-members of the selling group at a discount.) In accord with Section 26(f)(2) of Article III of the Rules of Fair Practice, Mr. Cody pointed out that he forsaw that the Committee had no established procedure to achieve this, so he suggested that a letter be sent by the Executive Director to underwriters and sponsors. This letter suggestion was adopted by the Board.

Item G. *Daily Price Changes.*

Ok to advise dealers in response to inquiries between "as of time" and "release time" (usually between 1:30 and 2:00) of the apparent direction.

EXHIBIT A

Transcript of Discussion
Re Investment Trust Rule—Rule 26

MR. VANCE: Apparently a number of questions have come up about investment trust matters that don't tie right into Rule 26. I thought I might try to explain the problems that have arisen, and then if there are any questions as to the effect of the rule on problems that you fellows have run into, I will do my best to try to answer them.

First, for the District Secretaries who were not with the Association at the time Rule 26 was drafted and put through—I believe it was two years ago this spring—I might say that the rule tries to do three things; first, under specific authority granted to the Association in the Investment Company Act, we set up a minimum basis for pricing trust shares—that is, open-end trust shares—so as to cut down to a practical minimum any so-called dilution that occurs when shares are sold during market hours.

What the rule requires is that shares must be priced at least twice each day, by inventory, so as to prevent any great variance between the price at which shares are issued and what the inventory value would be at the exact time of the sale. The problem is created by the fact that the market moves up and down and it is obviously impractical to take a complete inventory every ten minutes or every time that you get an order. By pricing on the basis of inventory twice every day we achieve a reasonable solution to the problem. And so far as we know, the Commission seems satisfied with it. While this is an essential part of Rule 26, it is nothing that need concern you fellows out in the field. It is a specific problem that applies solely to the underwriter and issuer at the time of the sale.

The other two things that the rule tries to do are: first, to protect investors in so far as repurchasing of shares is concerned. It does this in several ways which I shall be glad to go into if you have any questions. The second is to try to create more orderly distribution of investment trust securities. This, I feel sure, we have accomplished.

A problem that seems to have arisen recently is the question as to the maintenance of the public offering price on investment trust securities. Many dealers seem to think that there is an NASD rule which requires the maintenance of the offering price at the official public offering price established on the basis of inventory and as spelled out in the various prospectuses. That is not true. There is nothing in the NASD rules which requires any dealer to maintain a public offering price at any level. There is, however, a requirement in the Federal Statute—Investment Company Act of 1940—which says in effect that no dealer can sell to the public at any price except the official public offering price at the time the sale is put through.

We have tried to have that particular requirement duplicated in our rules, but the Commission at the time was very much invloved in the PSI case, and as a result we decided not to enter into any controversy and to stand purely on the section of the Investment Company Act, 22-D, that does make that requirement.

Several times I have raised the question as to whether the Association should do anything to attempt to enforce Section 22-D of the Investment Company Act—which is the section that requires maintenance of the public offering price on all sales to the public. This is a question of policy which I believe has not yet been decided.

Another question that has come up recently is that there are several houses which are not members of the Association, trading in the securities of open-end investment companies. These nonmember dealers maintain an active trading market, and dealers who are members of the Association have been wondering on what basis they can trade with the trader who is a nonmember.

There is another rule of the Association, as I understand it, which says that a member of the Association can sell a security to a nonmember-dealer only on the same basis as the member-dealer would sell the security to the public. And in the case of the open-end investment trust, a Federal statute has established the fact that a dealer can sell to the public only at the official public offering price. Therefore, if a member-dealer sells the shares of an open-end investment trust to a nonmember-dealer at below the official public offering price, he is violating a rule of the Association because the public offering price

in the case of an open-end investment trust is absolutely established by Federal statute and must be maintained.

Thus, the question of the inside market and the outside market, which comes up in a number of cases, as I understand it, when you try to apply the rule to trading between nonmember dealers and members does not come up with respect to shares of open-end investment trusts.

There have been several specific questions in connection with this phase of the problem. George Yancey, you asked a question a month or so ago which we haven't answered as yet. Do you want to raise that now, or have I answered it already?

Mr. George Yancey: The question came up in our District Committee and I asked it for the Committee. We had the impression that only dealers who had signed up on a syndicate agreement with a distributing trust were bound to maintain the offering price of that trust, but a dealer who had not signed up as a syndicate member of a distributing group could handle some other trust shares and would not be bound to maintain the public offering price of that trust share. If he bought it in the market and sold it at any price he wanted to, he would be doing the same thing as he would be doing had he purchased any other stock—it was just another security. That was the point that wasn't clear in my mind.

Mr. Vance: A dealer can trade with another dealer who is a member of the Association at any price he sees fit, but he cannot sell to the public at below the official public offering price. That is not because of any restriction in the Selling Group Agreement. It is because of a provision in the Investment Company Act.

Mr. Yancey: Regardless of whether he happens to be a member?

Mr. Vance: Regardless of whether he is a member of any selling group or what his position is.

Mr. Yancey: There is one other phase of this I would like to ask about. You have a dealer who is not a member of our Association, and he feels that he can purchase trust shares any place he wants to from the trading house and sell at any price.

Mr. Vance: The Investment Company Act specifically says "dealer", and a dealer is defined as being any person active in the security business within the United States,

whether or not he is a member of any association. So, if he is not a member of the Association, he still is bound by the Act.

QUESTION: What about the question of acting as agent for the buyer if the ultimate buyer happens to be a retail account?

MR. VANCE: An opinion has been handed down on Section 22-D which says that if a dealer—by that I mean anyone in the security business—acts as an agent, as a broker, between two individuals, there is nothing to prevent his effecting a transfer at any price agreed upon between the two individuals, the two principals. The problem that you run into, however, is that a dealer will attempt to get around 22-D by acting as a principal and selling through another dealer acting as a broker. The effect of such a sale is that the principal transaction runs through from the original dealer acting as the principal to the ultimate buyer, so that a violation of 22-D is involved.

As long as there is a dealer in the transaction acting as principal for his own account, the public offering price must be maintained.

QUESTION: Let's not complicate the question. Let's keep this simple illustration of acting as agent for the buyer. A dealer can act as agent for the buyer and seller if both the buyer and seller happen to be retail accounts. Is that right?

MR. VANCE: Yes.

QUESTION: Now, let's take another illustration and say there are two agents in which one acts as agent for the seller and one acts as agent for the buyer—is that a legal transaction?

MR. VANCE: That is a legal transaction. I wish that counsel were here to explain whether you are in effect acting as a principal if you solicit the transaction, but I don't think we ought to get into that today. Let's leave it simply that there can be one broker or ten brokers in-between so long as no dealer is involved, acting as principal for his own account.

QUESTION: I was wondering about an instance I bumped into of a dealer who is not registered with the SEC. Would he be bound by the Federal statute?

MR. VANCE: He is doing business within the state?

QUESTION: Yes.

Mr. Vance: Counsel says if he is doing an interstate business, he is bound by Federal statute. If he is doing an intra-state business, there is a question as to it.

Question: Mr. Vance, we have a problem down in our District as far as the disclosure on confirmations and sale of these investment trust shares is concerned. There is a difference of opinion among the various brokers dealing with the same investment trust as to the manner in which they should confirm.

Mr. Vance: I can only give you my opinion on this. I think that is a problem for counsel to answer. In the case of my own company, we are underwriters and we act as a principal when we buy shares from the trusts. We confirm them to the dealer as principal and require that the dealer in turn act as principal for his own account. Transactions of this nature are relatively simple; disclosure is made in prospectus and the sale made on the basis of the prospectus. There are several reasons why we operate as we do. One is the question of liability on the sale. There is an even more important question that has never been settled by the SEC, and that is whether, if the underwriter acts as an agent, he passes on to the dealer a possible underwriting liability.

There are a number of underwriters who act as agent. The underwriter acts as agent and the dealer in turn acts as agent. The purpose of this, of course, is to get around transfer taxes. Some dealers contend that although they are acting as an agent, as a broker in effect, they do not need to disclose on their confirmations the amount of the brokerage commission they receive. I don't see how they can get around such disclosure. I think the commission on the broker's transaction should be disclosed. I understand, however, that some dealers hold to the contrary. This question is now before the Investment Trust Committee and we shall report to you on it.

Question: If you sell an investment as agent, you are agent for the seller and not the buyer, and you would not have to disclose the commission. Say you are placing shares with the public. You are the agent for the seller, not the buyer, and you wouldn't have to disclose that. In acting as agent for the seller, you can disclose your commission to the seller and not to the buyer.

Mr. Vance: I will let counsel answer that.

Mr. Lindsey: That is the very question which has been raised. The contention has been made at the Commission (I don't know whether it is proper) that when you are acting as agent in that capacity, if you are a true agent for the seller, that is proper. But the Commission contends —and there are other people who contend—that actually you are agent for both parties of the transaction, and therefore you should disclose it to both sides of the transaction.

Question: May I ask a question about the responsibility of the dealer when he liquidates shares for an investor? Does he have any responsibility further than seeing to it that the retail customer gets the full liquidating value at that time?

Mr. Vance: Rule 26 says that if a dealer is a member of a Selling Group, he must agree to pay his customer not less than the official liquidating value at the time the repurchase goes through, although he may charge a reasonable commission for handling the transaction. We ran into considerable difficulty trying to control dealers who are not members of Selling Groups. Dealers who are not members of any group, particularly the trading houses, have in some instances attempted to buy shares from investors at below the official liquidating value and then turn around and immediately resell those shares at the liquidating value to the issuer.

We didn't want to spell out a price at which everyone had to buy shares, so we put in the requirement that the dealer who is not a member of a selling group must be a holder of record at the time he liquidates shares. This, in effect, means that the dealer who is not a member of a selling group (and thus subject to the requirement I have mentioned) cannot make a riskless profit because he has to buy the shares and hold them for several days while he is going through the process of transfer.

However, except for the dealer who is a member of a selling group, there is no restriction on the price which must be paid to the customer.

Question: When you talk about a reasonable commission, that implies an agency contract. I am thinking of a situation in which there may be a street market, and there are at least a few instances in which there is a street market in which the bid is higher than the liquidating.

MR. VANCE: That is true.

QUESTION: It is perfectly legal to see to it that the retail customer gets at least the liquidating, and the dealer can act as the principal and sell into the street market.

MR. VANCE: There is nothing to prevent that in the rule. There are certain provisions in some selling group agreements where the dealer—

QUESTION: I assume there is no selling group agreement.

MR. VANCE: There is nothing in the NASD rule to prevent the dealer paying a customer whatever he wants to and selling into the street market.

QUESTION: Is there anything in the Federal statute to prevent that?

MR. VANCE: No.

QUESTION: You can buy it for your own account as well as act as agent for the underwriters?

MR. VANCE: That is right.

February 11, 1941.

Mr. C. F. Cassell,
C. F. Cassell & Co.,
112 Second St., N. E.,
Charlottesville, Va.

Dear Mr. Cassell:

This is in reply to your letter of February 10 containing questions on the scope and provisions of the proposed amendment to the Rules of Fair Practice of the Association, adopted by the Board of Governors on January 20, 1941, relating to the underwriting and distribution of securities of open-end investment companies.

1. First, you ask, in essence, whether you, as a member of the Association, may sell securities of open-end investment companies on the over-the-counter market to another member of the Association if you are not a party to a selling agreement referred to in subsection (c) of the proposed amendment.

The answer to this is yes.

2. "Does each certificate have to be registered in our name before sale is made?"

No, unless you are not a party to a selling agreement and the sale is made to an underwriter or issuer.

3. "If we are not members of the National Association of Securities Dealer, Inc., is there anything to prohibit our trading investment trusts with other dealers who are not members?"

Of course, if you are not members of the Association, you will not be directly prohibited by the Rules of the Association from doing anything. To my knowledge there is nothing in the Investment Company Act of 1940 to prohibit dealers who are not members of the Association from trading securities of investment companies with other non-member dealers.

Yours very truly,
Wallace H. Fulton,
Executive Director.

7-m

GOVERNMENT EXHIBIT 21

GOVERNMENT EXHIBIT 22

March 29, 1954

Mr. D. J. Conway
Secretary, District Committee No. 2
National Association of Securities Dealers, Inc.
425 Bush Street
San Francisco 8, California

Dear D.J.:

Your letter of March 22, 1954, raises certain questions about transactions in investment company shares in the absence of a sales contract between the underwriter and the dealer involved.

As you describe the situation, the inquiring firm has, as a matter of policy, limited the number of selling group agreements it maintains with investment company sponsors to approximately twenty four. It has received through salesmen, however, orders for the shares of our investment company with whose sponsor they do not have an agreement. The dealer does not wish to sign an agreement with the sponsor of this investment company for a single transaction. The dealer reports that the wholesaler of the sponsor with which the dealer does not have an agreement has advised that the dealer could arrange to buy the shares "at some agreed price" from another dealer who does have a selling group agreement.

Section 26(c) states that no member who is an underwriter of the securities of open-end investment companies shall sell any such security at a price other than the public offering price unless (1) such dealer or broker is a member and (2) at the time of the sale a sales agreement is in effect between the parties.

It seems to me that if the transaction above were undertaken in the manner described, the sponsor of the investment company involved would be placed in the position of violating this section, unless the shares are to be resold by the dealer possessing the sales agreement to the inquiring dealer at the public offering price.

There is a further consideration, in that Section 26(f)(2) states, in part, that no member shall purchase securities of any open-end investment company other than for in-

vestment, except for the purpose of covering purchase orders already received. In the above transaction, should the dealer possessing the sales agreement take down the shares allegedly for investment, and actually resell them to the inquiring dealer "at some agreed price," the probability is, in my opinion, that the dealer taking down the shares would be in violation of Section 26(f)(2), unless the agreed price was the public offering price.

Still further, the typical selling group agreement provides that underwriters of investment company shares may sell to dealers having such selling group agreements at less than the public offering price only to fill orders from their customers, *none* of whom may be dealers. Of course, it is not known in this case whether the selling group agreement of the underwriter involved here contains this clause; such a provision is, however, standard in most agreements.

All in all, the transaction does not seem to be a proper one, and so long as the inquiring firm is not willing to arrange for a selling group agreement with the underwriter involved, it appears that the most practical course for the inquiring dealer to follow is to obtain the shares in the open market from one of the several specialists, such as Asiel & Co., or, perhaps, Merrill Lynch, or whoever makes the best market in such shares on the West Coast.

Sincerely,
Wallace H. Fulton
Executive Director

RM:mtn
7426

GOVERNMENT EXHIBIT 23

MEMORANDUM

March 2, 1956

TO: Mr. Fulton
FROM: Ray Moulden
SUBJECT: Section 26(c) of Article III of the Rules of Fair Practice

Brieger has raised certain questions as to the propriety or legality of procedures of some investment company sponsors under Section 26(c), as to (1) acceptance of orders prior to receipt of signed selling group agreement, and (2) timing and acceptance of orders received at or after the price change.

I've checked this with the Chairman of the Committee and with Counsel and the Assistant to the Executive Director. While not necessarily unanimous, these are the tentative conclusions:

I. 1. A selling group agreement can be said to be effective when a dealer has agreed by telephone, teletype or telegraph to sign and return the document (on the basis that all business done in the securities business is largely based on oral commitments, subject to some sort of later confirmation). There is no reason therefore (since for purposes of 26(c) and agreement is in effect) why a sponsor may not accept an order for shares from a dealer the same day or simultaneously that oral or other agreement is made by the dealer to sign and return the selling group agreement.

(If, of course, the commitment is not carried out, the situation is possibly the same as any other broken contract in the business.)

2. Vance, Sanders practice in more selective (they can afford to be). If the dealer is known or can be checked quickly, they'll accept the order subject to receipt of the signed agreement. If not known, and if the dealer won't commit to a long-term interest in handling shares, Vance, Sanders tells him to find the stock in the street or sell his customer something else.

II. 1. The price-change situation is more complex and we should bear in mind the opposing positions of responsibility of the sponsor/underwriter and the dealer, perhaps weigh the public interest involved—if any.

a. The underwriter is responsible to the investment company existing stockholders. Has duty to see to it that the trust receives the highest price possible.
b. The dealer is responsible to his customers. His duty is to see that the customers pay the lowest price possible.

The situation is just the reverse when a sale or redemption is involved.

2. a. In general, it seems to be the practice to accept orders at the prior-to-change price when "in-hand" at time of the change; when marked (teletyped or telegraphed) as placed prior to the change, though received afterward; when dealers say they have been on the phone or otherwise trying to get the order in for some time prior to the change. In other words, they are accepted on the basis of when initiated, and when this can be documented. (In general, that is; I'm sure the documentation isn't too good always.)

b. Vance, Sanders' situation is somewhat helped by its system of branch offices. These offices take orders up to the price change, then shut down and take care of confirmations and other details, leaving the wires open into Boston for last-minute direct orders, and then come in later on the wire with the material for the day.

But where an underwriter uses another dealer to clear, it isn't so easy. He's not so interested in getting in under the wire; he has his own business to handle and there may be some sloppiness in execution from the 26(c) standpoint.

c. We have to appreciate also that there really is a congestion problem in the last hour before a price change, and particularly when it appears the incoming price will be higher. You know, of course, that the standard practice among alert dealer firms is to hold customers orders through a day (or longer) waiting for an up-tick. On the first up-tick,

in they all go, and when that's compounded all over the country, it makes quite a congestion problem.

I'd like to discuss this with you.

Respectfully submitted,

RM:mtn
554

Opinion File
Investment Company Act '40
Section 22(d)—Redeemable Securities

July 25, 1941

Mr. John M. Baker
Stolle, Baker & Co., Inc.
Old National Bank Building
Spokane, Washington

Dear Mr. Baker:

With respect to the problem which you raise in your letter to me of July 22, I would think that, so long as you have selling agreements in effect with the national distributor of both of the trusts to which you refer, your dealings in the shares of such trusts as a dealer or broker would be governed by the provisions of the sales agreements, and as I do not have up-to-date copies of those agreements before me, I, of course, can not say what they provide with respect to such trading.

If you did not have such selling agreements in effect, then your activities as a broker or dealer in the shares of these trusts would be governed by Section 22(d) of the Investment Company Act of 1940. Sometime back, we asked the Commission for an opinion as to the applicability of said section to brokerage transactions and received an opinion from the General Counsel of the Commission in answer thereto. I am accordingly enclosing a copy of that opinion herewith, which I think you will find self-explanatory.

Very truly yours,
Wallace H. Fulton
Executive Director

GOVERNMENT EXHIBIT 24

INTERPRETATION
Investment Company Act 1940
Section 22 (d)

May 5, 1954

Mr. H. Peter Schaub, Jr.
Harry P. Schaub, Inc.
744 Broad Street
Newark 2, N. J.

Dear Mr. Schaub:

I have your letter of April 28, 1954. In response thereto, I wish to advise you that you could act as agent for both Customer A and Customer B in connection with the sale of XYZ Fund shares by Customer A and the purchase thereof by Customer B. In such event you need not maintain the public offering price, but it will be necessary for you to make disclosure to each customer as to commissions received or to be received. In that way you may reduce your over-all mark-up and load.

I hasten to point out to you, however, that you may sell only at the public offering price in a principal transaction, otherwise there is a violation of *Section 22 (d)* of the Investments Company Act of 1940, and the Association's Rules. I call your attention to pages E-107, E-108 and E-109 of the Association's Manual, which sets forth examples of this type of situation.

You will appreciate that the foregoing is an office opinion and not an interpretation of the Board of Governors, but is, I believe, consistent with the pages of the Manual cited.

Very truly yours,
Wallace H. Fulton
Executive Director

GOVERNMENT EXHIBIT 25

Government Exhibit 26

THE STATE OF WISCONSIN
Department of Securities
23 West, State Capitol
Madison 2, Wisconsin

July 18, 1961

National Association of Securities Dealers, Inc.
1707 H Street N. W.
Washington 6, D. C.

Attention Mr. Wallace H. Fulton
Executive Director

Gentlemen:

On or about May 22, 1961, this department issued a memorandum to Wisconsin securities dealers advising that shares of investment companies which are registered in Wisconsin may be purchased for a customer as his agent even though the sale is solicited, provided: that the confirmation states the price at which the security is purchased for the customer and a commission of not more than 5% is added thereto; and that the total cost to the customer does not exceed the asset value at the time of the transaction multiplied by 100/92.5.

We have been advised that the Chicago office of the National Association of Securities Dealers has informed one or more Wisconsin dealers that if they follow the above memorandum they will be in violation of the "Federal Law." We assume the Federal Law referred to is Section 22 (d) of the Investment Company Act of 1940, which requires a dealer to sell investment company shares at the current offering price, with certain exceptions set forth in that section of the law.

It is our position that Section 22 (d) of the Investment Company Act of 1940 applies to principal transactions by dealers. Section 22 (d) states ". . . no principal underwriter or dealer shall sell any such security . . . except at a current offering price . . ." The wording refers to a dealer selling, which would constitute a principal transaction as compared to a dealer purchasing for a customer on any agency basis. We call your attention to an opinion of General Counsel of the Commission, dated March 10, 1941,

directed to the National Association of Securities Dealers in response to a request for an opinion interpreting Section 22 (d) of the Investment Company Act of 1940, 41-44 CCH, 75140. That opinion stated that a dealer who is acting in the capacity of an agent for a selling investor or for a selling investor and a purchasing investor may make the sale at a price other than the current offering price described in the prospectus. We also call your attention to the Exchange Act Release No. 3769, dated January 4, 1946, 45-47 CCH, 77154, in which the above opinion was cited in a matter relating to the interpretation of Section 22 (d). This release also states that acting as agent for buyer or seller, with appropriate disclosure, a dealer unrestrained by Section 22 (d) could and should make the best possible deal for his customer.

It is apparent that the provisions of Section 22 (d) apply only to principal transactions, and this is further evidenced by the exception to that section granted in 1941 to permit varying prices for varying amounts of securities, provided the prospectus sets forth the price which a purchaser of any specific amount would be required to pay. Release 89, March 14, 1941, 41-44 CCH, 75141.

We are of the opinion that the above justifies the position of the department as set forth in our memorandum to dealers of May 22, 1961, and we cannot understand the position taken by your Chicago office. We request a clarification of your position or a retraction of the statement made to Wisconsin dealers by your Chicago office.

Very truly yours,
/s/ Edward J. Samp,
EDWARD J. SAMP
DIRECTOR

RJL:sl

c.c. - Mr. John F. Brady
Securities and Exchange Commission, Washington, D.C.
Securities and Exchange Commission, Chicago, Illinois

July 21, 1961

Mr. Edward J. Samp, Director
Department of Securities
The State of Wisconsin
23 West, State Capitol
Madison 2, Wisconsin

Dear Mr. Samp:

Your letter of July 18, 1961, describing your understanding of the opinion of Counsel and releases by the Securities and Exchange Commission regarding agency sales of investment company shares is in accordance with our views on this matter. Moreover, it also conforms with the understanding of the Investment Companies Committee of this Association.

I am sending a copy of this letter to our Chicago office.

Sincerely,
Wallace H. Fulton
Executive Director

rm/shh

GOVERNMENT EXHIBIT 27

GOVERNMENT EXHIBIT 28

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1707 H Street N.W. Washington 6, D. C.

September 1, 1961

Mr. John K. Kyle, Director
Department of Securities
23 West, State Capitol
Madison 2, Wisconsin

Dear Mr. Kyle:

Please refer to a letter over Mr. Edward J. Samp's signature dated July 18, 1961, and my reply thereto dated July 21, 1961.

My attention has been called to certain interpretations of my letter which lead me to conclude that a further amplification is necessary in order to remove misapprehensions which appear to be rather widespread in Wisconsin.

I agree with the view expressed by Mr. Samp that Section 22(d) of the Investment Company Act of 1940 does not apply to a transaction where a broker-dealer acts as agent for a purchasing investor in buying shares of an open-end investment company if the seller is another investor, or as agent for a selling investor and a purchasing investor in effecting a purchase of such shares. In those cases, neither the investment company, nor the principal underwriter, nor a dealer acting as principal is selling the shares. Accordingly, there is no statutory requirement that the transaction be at the current public offering price. In these narrow cases, the only requirement is that the agent act faithfully for his customer, state correctly the capacity in which

he acts and the price paid for the shares, and charge a commission which is reasonable under the circumstances.

I should point out, however, that the opportunities for effecting such transactions are not likely to be frequent. If the broker-dealer acting as agent for the purchasing investor, buys from (a) the investment company, directly or through the principal underwriter as its agent, or (b) the principal underwriter, acting as principal, or (c) *another dealer, who acts as principal*, the sale must be made at the current public offering price.

If the agent for the purchasing investor is not able to find another investor who wishes to sell the shares and so goes to the investment company or its principal underwriter or a dealer, I believe it is clear that he is buying the shares as agent for an investor. He cannot act as if he were a dealer on one side of the transaction and as agent on the other. If the broker-dealer discloses his agency capacity, the potential seller will be ill-advised to make the sale, since the seller is presumed to be responsible for the maintenance of the offering price but is not in a position to control the actions of the broker-dealer acting as agent for the purchasing investor. In turn, if the potential seller does make the sale and the agent broker-dealer confirms to his customer at other than the current offering price, such broker-dealer will be in a precarious situation, to say the least.

In summary, broker-dealers should not be encouraged to believe that by acting as agent they are exempt from Section 22(d). This is not the case in the ordinary situation and is true only in the rare instance where the broker-dealer acts as agent for a selling investor. We believe that your Notice to Dealers dated May 22 should be amended accordingly.

Very truly yours,
/s/ Wallace H. Fulton
WALLACE H. FULTON
Executive Director

GOVERNMENT EXHIBIT 29

MANAGERS AND DISTRIBUTORS OF: COMMONWEALTH INVESTMENT COMPANY, COMMONWEALTH INCOME FUND, COMMONWEALTH STOCK FUND

NORTH AMERICAN SECURITIES COMPANY
Investment Company Managers Since 1925
615 Russ Building, San Francisco 4

August 25, 1961

Mr. Wallace H. Fulton
National Association of Securities Dealers, Inc.
1707 H Street, N. W.
Washington 6, D. C.

Dear Wally:

I am enclosing two copies of a memorandum in which I have tried to record my thoughts and observations on the problem raised by Samp's letter to dealers last May.

I am sorry the memorandum is so long, but this is just the way it came out. In a nutshell, I am convinced that under the Lane opinion, Section 22(d) does not apply where a broker-dealer acts as agent for a selling investor, but that Section 22(d) does apply in any situation where a broker-dealer has entered the series of transactions as a principal, even though the broker-dealer making the retail sale (or executing his customer's purchase order) acts as agent. This is the typical situation when a broker-dealer acting as agent acquires shares of an investment company from a street-market dealer.

Since all of the papers you gave me in Seattle, as well as those given to me by John Hodges were photocopies of material in the Executive Office, I assume that there is no need for me to return these copies to you. Obviously, I shall be glad to do so if you want them, but the notes I have made on them might be helpful to me for future reference.

With best regards,

Sincerely,
/s/ Bob
Robert L. Cody

RLC/jh
Enclosure

Government Exhibit 30

MEMORANDUM

To Mr. Wallace H. Fulton August 22, 1961
From Mr. Robert L. Cody

Re. Application of Section 22(d) of the Investment Company Act of 1940 to transactions in which a broker-dealer acts as agent for a purchasing investor.

As you requested in Seattle, I have reviewed the correspondence in connection with Mr. Samp's notice to dealers dated May 22, 1961 regarding agency transactions in investment company shares.

Although I discussed this matter briefly with Frank Johnson in Seattle, I did not have an opportunity to do so after I had received the complete file. Consequently the views expressed in this memorandum are my own and do not necessarily represent Frank's thoughts on the matter.

It is evident that although Samp was presumably interpreting Wisconsin regulations for Wisconsin dealers, he was confident in his letter of July 18 that the suggested procedure was not in violation of Section 22(d). This confidence, in turn, was based primarily upon Chester Lane's opinion dated March 10, 1941, in which Lane stated that "if a broker-dealer in a particular transaction is acting solely in the capacity of agent for a selling investor, or for both a selling investor and a purchasing investor, the sale may be made at a price other than the current offering price described in the prospectus."

In this opinion, Lane also said that in his view the term "dealer," as used in Section 22(d), refers to the capacity in which a broker-dealer acts in a particular transaction. This is somewhat at variance with the definition of a dealer in Section 2(a) of the Act, which does not limit the term to a specific transaction but says that a dealer is any person *regularly engaged* in the business of buying and selling securities for his own account.

It might be argued that if a broker-dealer meets the definition of Section 2(a)(11) of the Act, he is obligated to maintain the offering price even though in the specific transaction he was acting as agent. I don't think it is necessary, however, to base a position upon this definition.

August 22, 1961

It is essential to keep in mind the roles which a broker-dealer may play in any single transaction. I say this because there seems to be some confusion in this regard in the correspondence in this case. Normally, of course, a broker-dealer acts as principal in the sale of investment company shares. This is true whether the underwriter from which the broker-dealer acquires the shares is acting as principal or as agent for the investment company. In the exceptional kind of transaction we are discussing here, a broker-dealer may act as agent for a purchasing investor, or as agent for a selling investor, or as agent for both the purchasing investor and the selling investor. In any transaction in which the broker-dealer acts as agent, the broker-dealer cannot also act as principal.

I believe that the Lane opinion makes it very clear that where the broker-dealer is acting as agent for the purchasing investor and the selling investor, the sale may be made at a price other than the current offering price. I believe that Bill Shelley concurs with this position also. Naturally, the broker-dealer is required to make the necessary disclosure to his customers regarding his actions as agent.

The Lane opinion is, I believe, a little confusing when it refers to transactions in which the broker-dealer acts solely in the capacity of agent for a selling investor. Shares which the broker-dealer sells as agent for the investor must be sold either to (a) the investment company, (b) the underwriter, (c) a purchasing investor, (d) a purchasing investor for which the broker-dealer is acting as agent, (e) a purchasing investor through another broker-dealer which is acting as agent for the purchasing investor, or (f) to a broker-dealer purchasing as principal. No question regarding Section 22(d) is involved in (a), (b), or (f). Further, the Lane opinion makes it clear, as I have indicated above, that Section 22(d) does not apply in (d). This leaves (c) and (e). The Lane opinion says that in the case of (c), Section 22(d) does not apply, and I do not believe that anything is mentioned about (e). It would appear, however, that the reasoning which excludes (d) would also exclude (e).

Mr. Samp appears to have failed to take into account the next to the last paragraph of the Lane opinion. This paragraph states that if a broker-dealer sells as principal, Section 22(d) applies even though there is an intervening agent

between the principal and the investor, whether the investor is a selling investor or a purchasing investor. Thus, the source of the shares which the broker-dealer sells as agent becomes a controlling factor.

In the rare situation where the broker-dealer acts as agent for the selling investor, Section 22(d) does not apply, whether the broker-dealer acts as agent of the purchasing investor or simply sells to the purchasing investor on behalf of the selling investor. As indicated, this situation is bound to be rare, and ordinarily the shares acquired for the purchasing investor must be acquired from a source other than a selling investor. Ordinarily the source will be another broker-dealer. (Obviously, this excludes the normal situation under which the shares are acquired from the underwriter pursuant to a sales agreement which provides that the broker-dealer must act as principal.)

As a practical matter the problem we face is the resale of shares acquired from a street-market dealer who is acting as principal. The Lane opinion seems to me to cover this situation. Where the street-market dealer acts as principal, which is ordinarily the case, it is clear that a retail sale by the street-market dealer must be at the current offering price. Furthermore, even if there is an intervening broker-dealer acting as agent (and ordinarily this would be as agent for the purchasing investor), the offering price must be maintained.

This strikes at the very heart of the street market. It means that the street-market dealer must not only maintain the offering price in retail sales as principal, but that it must be responsible for the price at which another broker-dealer sells the shares, unless that broker-dealer purchases from the street-market dealer as principal.

A broker-dealer cannot purchase as principal and turn around and sell to its customer as agent. It appears to me that the original letter which you wrote to Mr. Samp on July 21 would have been appropriate if it had related solely to agency transactions where the source of the shares was a selling investor and no broker-dealer entered the picture as a principal. Actually, however, this would be extremely rare, and a letter could properly be sent to Samp's successor expanding upon this position, pointing to the misuse which has apparently been made of the earlier letter. A key point

is that a broker-dealer cannot purchase shares as principal and turn around and sell those shares to a customer as agent for that purchasing customer. The Lane opinion "exemption" applies only where the broker-dealer is acting as agent for a selling investor; Section 22(d) applies whenever the broker-dealer has acted as principal or when any other broker-dealer in the course of a series of transactions which result in the sale of shares to a purchasing investor has acted as principal.

I don't think the solicited versus unsolicited question is particularly pertinent, either in Samp's notice to dealers or in Bill's letter of August 4. The main points are the capacity in which the broker-dealer acts and where the broker-dealer gets the shares, not whether he solicits the order.

Regarding the draft which Bill sent to Ray on August 8, I have these comments:

I would add "broker-" before "dealer" in line 3 of paragraph 3 and in line 3 of paragraph 4.

In paragraph 4, I would delete the last four lines, except the word "price".

On page 2, I would add "as agent" before the word "for" at the end of line 3, and omit "In other words," in line 4.

I would delete the last sentence of the same paragraph, and add the following: "If the broker-dealer discloses his agency capacity, the potential seller will be ill-advised to make the sale, since the seller is presumed to be responsible for the maintenance of the offering price but is not in a position to control the actions of the broker-dealer acting as agent for the purchasing investor. In turn, if the potential seller does make the sale and the agent broker-dealer confirms to his customer at other than the current offering price, such broker-dealer will be in a precarious situation, to say the least.

In summary, broker-dealers should not be encouraged to believe that by acting as agent they are exempt from Section 22(d). This is not the case in the ordinary situation and is true only in the rare instance where the broker-dealer acts as agent for a selling investor. We believe that your Notice to Dealers dated May 22 should be amended accordingly.

Robert L. Cody

RLC/jh

Government Exhibit A-1

(Title Omitted in Printing)

PLAINTIFF'S FIRST REQUEST FOR ADMISSIONS ADDRESSED TO NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 36 of the Federal Rules of Civil Procedure, plaintiff requests that defendant National Association of Securities Dealers, Inc. ("NASD"), within days after service of this request, admit that each of the following statements is true:

1. In March, 1959, after having polled the members of its Investment Companies Committee, defendant NASD approached the Staff of the Securities and Exchange Commission ("SEC") with a proposed Interpretation of Rule 26(f)(2) of the NASD Rules of Fair Practice which would have prohibited dealers from purchasing shares for resale to other dealers.

2. On March 11, 1959, SEC Staff officials indicated that nothing in the securities statutes or their legislative history would support the proposed Interpretation of Rule 26(f)(2) of the NASD Rules of Fair Practice, that the Staff would oppose the proposed Interpretation if it were formally submitted to the Commission, and that NASD enforcement of selling group agreements was prohibited by prior Commission decision.

3. On June 22, 1959, the NASD sent a letter to all member underwriters and distributors of investment company shares urging them to amend their selling group agreements to prevent dealers from purchasing shares for resale to other dealers and urging strict enforcement of agreements so amended.

4. The NASD did not submit the letter referred to in paragraph 3 above to the SEC for prior approval.

5. For many years, up to and including the date of the filing of the complaint herein, the NASD had knowledge of the existence of a secondary dealer market in mutual fund shares.

6. For many years, up to and including the date of the filing of the complaint herein, the NASD acted upon the understanding that a brokerage market in mutual fund shares did not violate the Investment Company Act, as

amended, 15 U.S.C. § 80 a-1, *et seq.* ("Investment Company Act").

7. For many years, up to and including the date of the filing of the complaint herein, the NASD acted upon the understanding that a secondary dealer market in mutual fund shares did not violate the Investment Company Act.

8. For many years, up to and including the date of the filing of the complaint herein, a small number of firms actively made secondary dealer markets in mutual fund shares.

9. For many years, up to and including the date of the filing of the complaint herein, the SEC knew of the existence of a secondary dealer market in mutual fund shares.

10. The SEC has never alleged that a secondary dealer market in mutual fund shares violates the Investment Company Act.

11. The SEC has never alleged that a brokerage market in mutual fund shares would violate the Investment Company Act.

12. At no time prior to the filing of the complaint herein did defendant NASD complain to the SEC, seek a declaratory judgment from the SEC or a District Court, or bring suit in a District Court, alleging that a secondary dealer market or a brokerage market violated the Investment Company Act or the Maloney Act, 15 U.S.C. 780, *et seq.*

13. The NASD Manual for many years has stated that a member could execute a mutual fund transaction as agent between two customers at less than the public offering price without violating Section 22(d) of the Investment Company Act.

14. The NASD Manual for many years has stated that a member could sell a mutual fund share in the secondary dealer market to another dealer at less than the public offering price without violating Section 22(d) of the Investment Company Act.

15. The SEC has known of the provisions in the NASD Manual referred to in paragraphs 13 and 14 above.

16. The SEC has never requested the NASD to change the provisions in the NASD Manual referred to in paragraphs 13 and 14 above nor has it ever suggested that either of these provisions was erroneous.

17. For many years, the NASD has acted upon the understanding that shares of defendant mutual funds are trans-

ferable either fully or in the customary manner in which shares of stock are transferable.

18. For many years, up to and including the date of the filing of the complaint herein, the share certificates of defendant mutual funds contained no restrictions prohibiting secondary dealer markets or brokerage markets in the shares of defendant funds.

DANIEL R. HUNTER

PHILIP L. VERVEER

RONALD J. SILVERMAN
Attorneys, Department of Justice

EXHIBIT A

Exhibit A of Defendant Bache & Co., et al. Attached to Reply Memorandum in Support of Motions by the Defendant Dealers to Dismiss the Complaints, Filed July 20, 1973

ASIEL & CO.
New York Stock Exchange Building
New York

August 29, 1940

Mr. Wallace H. Fulton, Executive Director
National Association of Securities Dealers, Inc.
821 Fifteenth Street, N. W.
Washington, D. C.

Dear Sir:

We understand that the Executive Committee of the Board of Governors of the National Association of Securities Dealers is about to consider a proposed addition to Article 3 of the Rules of Fair Practice of the Association. This concerns the activities of members in connection with the securities of open end management companies.

It is our opinion that Section 26, sub-section "F" of the proposed addition will force all dealers who may have sales agreements with underwriters of open end shares to dispose of *presently outstanding* shares only to the underwriters at the underwriter's bid price unless they happen to have a retail order which they can fill with these shares. We object to this provision. We consider that it is definitely contrary to the interest of the members and the investing public to restrict the bid side of the market for the 90 million presently outstanding open end shares.

The underwritings covering these shares are not limited to comparatively short periods as are the usual distribution syndicates formed to sell particular issues, but in many instances have continued over a period of years. Therefore, we feel strongly that a free market should be allowed to exist for shares which have been in investors hands, sometimes for years.

Sub-section "H" seems very objectionable to us. It will give the sanction of a National Association of Securities Dealers rule to a proposed discriminatory practice on the

part of the underwriters. This provision would make it necessary for an independent dealer to become a record owner for any security tendered for repurchase by the issuer or underwriter but would not require this of other dealers.

We also object to sub-section "I" because we think it puts the National Association of Securities Dealers on record as not objecting to and possibly encouraging the type of discrimination mentioned above.

We wish to urge you to place our views in this connection before the Executive Committee with the hope that they will delete the above mentioned provisions from the proposed addition to the Rules of Fair Practice of the Association before submitting it to the membership for a vote.

In order to acquaint you more fully with our views we enclose a memorandum on the law itself which we presented to the S. E. C.—unfortunately too late to have any effect.

Yours very truly,

NHW/db

August 26, 1940.

Mr. Robert H. White,
Asiel & Co.,
New York Stock Exchange Bldg.,
New York, N. Y.

Dear Mr. White:

We acknowledge receipt of your letter with regard to the proposed addition to Article III of the Association's Rules of Fair Practice and enclosed Memorandum Covering S. 4108 which you presented to the Securities and Exchange Commission.

Your views in this connection will be placed before the Executive Committee for their consideration.

Very truly yours,

Wallace H. Fulton,
Executive Director

MEMORANDUM COVERING S. 4108

A Bill to provide for the registration and regulation of investment companies and investment advisers, and for other purposes.

1. *How Street Dealers Operate:*

As we read Sec. 22(d) of the proposed bill, it will seriously curtail free "street" trading in the redeemable securities of open-end investment companies.

As of June 30, 1940, eighty active open-end investment companies had about 90,000,000 shares outstanding, valued at about $375,000,000. This is indicative of the large floating supply of *presently outstanding* shares which furnishes the medium for dealings by the street dealer. The street dealer purchases these shares from the investor who prefers to sell his shares in the free and open market instead of redeeming them or selling them back to the principal underwriters. The investor prefers to do this for several reasons.

First, it may take several days to forward a trust certificate for physical presentation to secure redemption, whereas there is no delay involved in selling immediately to a street dealer.

Second, the investor may get a higher price from the street dealer than from the investment company on repurchase.

The street dealer, by handling numerous inquiries to buy and sell these securities, is in a position to make a close market, to the advantage of the private investor; and by maintaining an extremely flexible and sensitive market, as contrasted with the rigid market of the underwriter, he is able to give the investor the full benefit of stock market fluctuations.

2. *Section 22(d) of the proposed law:*

Subdivision (d) as presently proposed reads as follows:

"(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no

principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus: ***"

Under this provision the street dealer will not be able to sell any of these shares to a broker or individual except at the current public offering price. This current public offering price represents the price established by the principal underwriter after adding a sales load of approximately 7½% or 8% to the asset value of the shares, and is almost always higher than the price at which the same shares could be procured from the street dealer. If Section 22(d) goes into effect, it will be impossible for an individual investor or a broker to take advantage of the lower market made by the street dealer.

3. *The purported "basis" of Section 22(d)*:

It has been asserted that the operations of street dealers have resulted in certain abuses, and the enactment of Section 22(d) will eliminate these abuses. The claimed "abuses" are that the activities of the independent dealers:

(a) Create unfair competition between "authorized" dealers (i.e. dealers in privity with the principal underwriters) and street dealers, to the prejudice of the former;

(b) Make possible "raids" on the investment trusts;

(c) Are conducive to switching operations; and

(d) Frequently result in riskless trading and the dilution of trusts.

We submit that these "abuses" may not properly be laid at the door of the street dealer.

4. *"Unfair Competition"*:

When shares are sold in the first instance by the principal underwriter through authorized dealers to the individual investor, the price includes all selling expenses, plus a selling profit to both the authorized dealer and the principal underwriter.

If an investor later sells these shares to a street dealer and the latter resells them in the open market to another investor or a broker at a price which does not include the full amount of the original sales load, no unfairness results to the authorized dealer. He made his selling profit on the original transaction. The investor is benefitted by securing

the shares at the lower price. It would seem highly unfair and unjust to the investor to keep burdening each successive transaction with a sales load.

5. *"Raiding" trusts.*

"Raiding" occurs when there is a concerted campaign to persuade investors to liquidate their holdings in a certain trust. It is usually instigated by the selling organization of a rival trust. The street dealer is not involved in such operations.

6. *"Switching":*

Raiding and switching are related operations. The purpose of a raid ordinarily is to persuade the holders of shares of one trust to unload their holdings and to purchase instead the securities which are being offered for sale by the selling organization engineering the raid. The street dealer customarily deals with brokers and dealers. He does not as a rule come in actual contact with individual investors, and has no opportunity to participate in or to instigate switching operations.

7. *Dilution and Riskless Trading:*

The problem of dilution and riskless trading is inherent in the existing pricing method of selling open-end shares. Dilution occurs when shares are sold by an investment company at less than asset value at time of sale. This is due to the fact that the company gives its authorized dealers a firm option (usually for a day) to buy shares at a price based on the previous day's closing. In a rising market the authorized dealers purchase stock from the company at a price based on the lower closings of the previous night, thereby acquiring shares for less than their true value at the time of acquisition, to the detriment of the present shareholders. This practice is aggravated when the dealers manage to sell back their shares immediately to the company at a profit to themselves, obviously at the expense of the trust and without risk. There can be no doubt that this represents an unwholesome condition, but Section 22(d) is not needed to eliminate it. It is already covered by Section 22(a), which is designed to eliminate riskless trading and dilution. Dilution with respect to street dealers presents no real problem. Nearly all sales agreements between authorized dealers and

principal underwriters forbid the former to sell shares at less than the current public offering price.

8. *The Real Basis for Section 22(d)*:

It will be seen from the foregoing that if there are any "abuses" in the sale of trust shares, the street dealers cannot be blamed for them. One is impelled to the conclusion that the "reasons" advanced for enacting Section 22(d) have no foundation in fact. If the provision will achieve anything at all—and we think it was designed for this purpose—it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly. Instead of being protected and benefitted, the investor will be gravely prejudiced.

9. *Proposal.*

The street dealer performs a useful function in maintaining a close market in trust shares. The maintenance of such a market is decidedly to the benefit of the investor. The activities of the street dealer in this direction should not be hamstrung by legislation. It is submitted that the proposed form of Section 22(d) should be changed to read as follows:

> "(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, *a broker*, a principal underwriter or the issuer, except at a current public offering price described in the prospectus: ***" (The words "a broker" have been added.)

EXHIBIT B

Exhibit B of Defendant Bache & Co. et al. Attached to Reply Memorandum in Support of Motions by the Defendant Dealers to Dismiss the Complaints, Filed July 20, 1973

Telephone JOurnal Square 2-4400

Cable Address "Accurate"

GOODBODY & CO.
formerly
Robert Goodbody & Co.
Established 1891
921 Bergen Avenue, Jersey City, N. J.

Managers
James F. Kennedy
Edward J. Wright

Main Office
115 Broadway
New York, N.Y.

Members
New York Stock Exchange
New York Curb Exchange
Chicago Stock Exchange
Chicago Board of Trade
New York Cotton Exchange
and
Other Principal Exchanges

July 16, 1940

Mr. Wallace Fulton
Executive Director, N. A. S. D.
Washington, D. C.

Dear Mr. Fulton:

My attention has been called to a proposed amendment to the rules of Fair Practice of the N. A. S. D. It is also my understanding that this proposal emanates from the Investment Trust Security Dealers Association, an organization representing the sponsors of investment trust issues.

If this amendment is what I understand it to be an amendment such as this would eliminate all competitive bids or offers made in a free and open market and would serve one purpose only namely, of protecting syndicate houses against healthy competition. It has been unfair practice in the past such as this amendment, that has brought disfavor on the heads of all security brokers. A law to protect a chosen few who think they are sitting in the inner circle, but giving no

constructive thought to the millions of investors who have an interest in these securities. An amendment such as this will not give the investing public the protection they are entitled to. Healthy competition has always been the life blood of all business and by eliminating this you have one answer only but it is not the right answer. This amendment is a confession by the syndicate houses that if they can liquidate their competition they will have a closed field for themselves. The open trading done in all Investment Trust issues has at no time stopped syndicate houses from selling additional securities for in the past few years there have been millions of additional securities of this type sold to the investor.

Since this department has been active in trading these securities for many years, we would deeply appreciate being informed of this proposed amendment and whether or not the Board of Governors or any committee of the association has or is to hold hearings on the question of its adoption. If a hearing is to be held, we should like to know the date and place of such hearing.

Telephone JOurnal Square 2-4400

Cable Address "Accurate"

GOODBODY & CO.
formerly
ROBERT GOODBODY & Co.
Established 1891
921 Bergen Avenue, Jersey City, N. J.

Managers	Members
James F. Kennedy	New York Stock Exchange
Edward J. Wright	New York Curb Exhange
	Chicago Stock Exchange
	Chicago Board of Trade
Main Office	New York Cotton Exchange
115 Broadway	and
New York, N. Y.	Other Principal Exchanges

July 16, 1940

We presume that the association will afford an opportunity to dealers likely to be affected by any such amendment to study the proposal and to be heard before its adoption by the Board of Governors.

Yours very truly,

GOODBODY & CO.

GKS/M

July 19, 1940

Mr. G. K. Shields
Goodbody & Co.,
921 Bergen Avenue,
Jersey City, N. J.

Dear Mr. Shields:

I have referred your letter of July 16 to Mr. Henry Vance, Chairman of our Investment Trust Underwriters Committee, who will be very happy to discuss with you the proposed rules having to do with investment trust securities.

These rules are only in tentative form. They have not been presented to the Board and probably will not be considered by the Board at its meeting on July 22 and 23, but rather will be referred to a sub-committee of the Board for consideration.

You may be sure that if you have any further questions after discussing this matter with Mr. Vance, you will be given an opportunity to present your views before the sub-committee.

Very sincerely yours,

Wallace H. Fulton,
Executive Director.

LAURENCE M. MARKS & CO.
Investment Securities
49 Wall Street, New York
Tel. HAnover 2-9500

Members
New York Stock
Exchange

Cable Address
Rencemark, N.Y.

August 22, 1940.

Mr. Wallace J. Fulton, Director
National Association of Securities Dealers, Inc.
821 West 15th Street, N.W.
Washington, D. C.

Dear Wally:

For your information I attach a copy of a letter which I received today from Mr. Shields of Goodbody & Company.

With very kindest regards, I am,

Sincerely,

LMM:MLF

COPY

GOODBODY & CO.
Jersey City, N. J.

August 21, 1940

Mr. Lawrence M. Marks
Lawrence M. Marks & Co.
49 Wall Street
New York City

Dear Sir:

You are no doubt familiar with the text and history of the Wagner-Lea Bill to regulate investment companies which has just been passed by both Houses of Congress. We believe that this bill, which was drawn up with the assistance of a small committee of representatives of the underwriting houses, as a whole is an excellent bill. Due to the fact however that brokers and dealers had no representation, it has been possible to insert into this bill a paragraph which only protects the underwriting houses but is detrimentally harmful both to the investing public and to the street.

The joker is to be found in section 22 paragraph D, which paragraph we together with others have vigorously but unsuccessfully opposed in Washington. A memorandum prepared by us and our Associates and sent to every individual Senator explaining our objection is enclosed herewith.

We doubt that it has been generally realized that under this section it will be illegal for a broker to come into the independent street market and buy for a client any mutual trust shares, unless his client is charged the full published offering price established by the underwriter. In other words if the street is quoting Massachusetts Investors Trust 17¼-½ and the market published by Massachusetts Distributors is 17.25-18.55, any broker buying for account of a customer must buy the stock not below 18.55. His client is compelled to pay 18.55 plus commission or $1.05 more than he should.

We fully realize the work and expense incurred by the underwriters in creating trust shares. An investment trust issue however should not be confused with a limited bond

or stock issue sold through a syndicate of dealers. Trust issues are continuously offered and there is no question that the loading charge of 7½ of 8% should be levied upon any newly created shares, but we do not see why the same charge should be borne over and over again whenever shares created years ago are turned over and traded in a free and open market.

While the fight against this paragraph will undoubtedly continue with the hope of having this paragraph eventually amended, the underwriters committee of the N.A.S.D. has drawn up a similar proposal to be voluntarily adopted by the N.A.S.D. The Board of Governors is now considering the draft to be submitted to the members for a vote.

In the interest of re-establishing a free and open market in these securities when and if an amendment to the Wagner-Lea Bill can be put through we again vigorously oppose the passage of this rule by the N.A.S.D. which, by voluntary action along the lines of the disputed paragraph, would make any further Congressional action impossible.

Some time ago we wrote in this connection to Wallace H. Fulton, Executive Director of the N.A.S.D. He referred our letter to Mr. Vance, who he stated is working out these rules in the interest of the industry. Obviously Mr. Fulton and possibly the Board of Governors of the N.A.S.D. are not aware of the fact that Mr. Vance is not representing the industry as a whole but only a faction, the very faction which we believe is attempting, for selfish reasons, to restrict free and open trading.

We appeal to you as a member of the Board of Governors to give this matter your most considerate attention and voice your objection to this rule before the Board.

We urgently request that you will allow representatives of brokers and of the trading fraternity to express their views on this matter before any action is taken.

Yours very truly,

GOODBODY & CO.
S/ G. K. Shields
Manager of Investment Trust
Trading Department

GKS/M

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE GENERAL COUNSEL

August 9, 1973

Honorable Howard F. Corcoran
Judge, United States District Court
for the District of Columbia
United States Courthouse
Washington, D.C. 20001

Re: *United States* v. *NASD, et al.*, No. 338-73 (D.D.C., filed February 21, 1973) and related cases.

Dear Judge Corcoran:

This letter is in response to your invitation to the Commission to participate in the above referenced cases. First let me thank you for offering to us the opportunity to express our views in this matter.

The Commission is concerned that these antitrust actions may involve attacks on the rules of the National Association of Securities Dealers ("NASD") over which the Commission is granted exclusive original jurisdiction by Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3, et seq. (the Maloney Act). If, in considering the defendants' present motions to dismiss, you determine that the rules of the NASD are the object of these antitrust actions, or, if the motions to dismiss are denied and the facts adduced at trial demonstrate that rules of the NASD are being attacked by the plaintiffs under the antitrust laws, then the Commission would likely wish to participate in these cases in order to protect its jurisdiction. As we read the plaintiffs' complaints, and briefs and affidavits in opposition to the motions to dismiss, however, the precise factual scope of their antitrust attack does not seem sufficiently developed to allow this Office to recommend to the Commission that it participate in these cases at this time.

We would like to assure you that these cases are being observed carefully by the Commission's staff in order to insure that we may promptly bring to your attention any

conflicts between the Commission's exclusive original jurisdiction under the Maloney Act and your jurisdiction under the antitrust laws. The Maloney Act was enacted to encourage the formation of self-regulatory organizations, *inter alia,* in order to avoid some of the expense of complete direct regulation of the over-the-counter markets, and to avoid involving the government in the establishment of ethical, as opposed to legal, business standards.[1] Congress contemplated that the Securities and Exchange Commission would "exercise appropriate supervision in the public interest"[2] over the activities of these self-regulatory organizations and further granted to the Commission "supplementary powers of direct regulation."[3] Accordingly, in order for an association of over-the-counter broker-dealers to be registered under the Maloney Act, the Commission has to find that the association's rules meet a number of standards specified in Section 15A(b), including that they are designed "to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers . . . ," Section 15A-(b)(8). In the same manner, for a registered association to amend its rules, the Commission must find, under Section 15A(j), that the amendment is consistent with the standards of Section 15A(b). And Section 15A(k)(1) of the Act authorizes the Commission, "after appropriate notice and opportunity for hearing," to abrogate rules of a registered association, "if such abrogation is necessary or appropriate to assure fair dealing by the members of such association . . . [or] to protect investors or effectuate the purposes of this title."[4] Among the purposes of the title are the competitive considerations contained in Section 15A(b)(8). Finally, Section 15A(n) of the Maloney Act provides that:

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[1] Senate Committee on Banking and Currency, Regulation of Over-the-Counter Markets, S. Rep. No. 1455, 75th Cong., 3d Sess. 3-4 (1938).

[2] *Id.*

[3] *Id.*

[4] The Commission's authority under 15A(k)(1) extends to partial abrogation of a rule of a registered association insofar as the rule has been interpreted or applied by the association in a manner inconsistent with the purposes of the Maloney Act. *See* Securities and Exchange Commission, Securities Exchange Act Release No. 9632 (June 7, 1972).

"If any provision of [the Maloney Act] . . . is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provisions of this section shall prevail."

The Maloney Act thus vests in the Securities and Exchange Commission broad regulatory authority over the rules of registered over-the-counter broker-dealer associations like the NASD, and provides for precise standards and procedures to be employed by the Commission in authorizing or reviewing those rules.

Silver v. *New York Stock Exchange*, 373 U.S. 341 (1963), is generally regarded as the leading case on the relationship between the Securities Exchange Act and the antitrust laws. That case, however, as the court pointed out, involved particular action by the New York Stock Exchange which was not subject to Commission review, and the court attached significance to that fact. For example, it said "Should review of exchange self regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12 *supra*." (373 U.S. 341, at 360). Note 12, to which the court made reference, referred expressly to the Commission's jurisdiction under the Maloney Act and stated that were there such Commission jurisdiction in the *Silver* situation, "a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity, an issue we do not decide today." (373 U.S. 341, 358, n. 12). The present action may be that "different case" but, as we pointed out at the beginning of this letter, this will depend upon determinations concerning the relationship of this action to the rules of the NASD which have not as yet been made. In *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289, 302-303 n. 13 (1973), the Supreme Court recognized that where a regulatory act contains an express exemption from the operation of the antitrust laws, or where a regulatory agency is specifically directed to consider competitive factors in the exercise of its duties, it is necessary to conclude that Congress intended to exempt from the antitrust laws activity subject to the administrative agency's adjudicative or rule-making authority. If *United States* v. *NASD* and its related cases do in fact constitute attacks on matters which are within the Commission's supervisory jurisdic-

tion over NASD rules then the teaching of *Ricci* and the very structure of the Maloney Act require you to conclude that these cases cannot be maintained under the antitrust laws.[5]

Although we have determined not to participate in these cases—at this time—by the filing of an *amicus* brief, we will remain vitally interested in the case and the specific legal issues being raised. Your courtesy in offering us the opportunity to participate at this time, however, is greatly appreciated.

Sincerely,

Lawrence E. Nerheim
General Counsel

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[5] The Commission's position in this regard is, of course, contrary to the decision in *Harwell* v. *Growth Programs, Inc.*, 451 F. 2d 240 (C.A. 5, 1971), *opinion modified and petition for rehearing denied*, 459 F. 2d 461 (C.A. 5) (per curiam), *certiorari denied*, 409 U.S. 876 (1972), where the Court concluded that a district court in a private antitrust suit may enjoin compliance with an NASD interpretation of one of its rules which the Commission had urged the NASD to promulgate. Aside from the fact that *Harwell* has the effect of reading out of the Maloney Act the procedures and standards established by the Act for approving and reviewing NASD rules, and the express antitrust exemption of Section 15A(n), it is worth noting that that opinion was decided before the Supreme Court explained in *Ricci* that a regulatory scheme like the Maloney Act precludes *de novo* antitrust actions.

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D.C. 20530

August 20, 1973

Honorable Howard F. Corcoran
United States District Court
for the District of Columbia
Washington, D. C. 20001

Re: United States v. NASD, et al. (No. 338-73)

Dear Judge Corcoran:

This correspondence concerns the letter sent by Lawrence E. Nerheim, General Counsel of the Securities and Exchange Commission to you on August 9, 1973, declining on behalf of the Commission to participate in *United States* v. *NASD* and related cases.

Mr. Nerheim's letter raises the question of the relationship of the Government's case to the NASD's Rules. We would like to clarify any possible confusion on this issue. While the Government believes that, in an appropriate case, it would not be precluded by either the Maloney Act, 15 U.S.C. § 78o-3, *et seq.* or *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289 (1973), from challenging a specific NASD rule under the antitrust laws, the instant case does not pose this issue since it does not represent an attack upon NASD Rules as such. Count I of the complaint is aimed at an over-all course of conduct engaged in by the NASD and its members going beyond the NASD's rule making authority. An example of the type of conduct we are challenging is illustrated by GX 14 through GX 19, attached to our Memorandum of Points and Authorities In Opposition to Defendants' Motions to Dismiss.

It is my present view that, should the Government prevail, it could obtain effective relief without the abrogation or alteration of any existing NASD Rules.

Sincerely yours,

BRUCE B. WILSON
Acting Assistant Attorney General
Antitrust Division

By: Daniel R. Hunter
Attorney, Department of Justice

cc: All counsel in *United States* v.
NASD, et al.

(Title Omitted in Printing)

Friday, August 3, 1973
Washington, D.C.

The above-entitled matters came on for hearing before The Honorable HOWARD F. CORCORAN, United States District Judge, at 9:30 a.m.

APPEARANCES:

PHILLIP VERVEER, Esq. and
CARL SCHWARZ, Esq.
For the Securities and Exchange Commission

DAVID BERGER, Esq.
For Plaintiffs in CA 426-73

OWEN JOHNSON, JR., Esq.
For Broker-Dealer defendants

WILLIAM MEAGHER, Esq. and
DANIEL LEVIN, Esq.
For the Fidelity Fund

JOSEPH LEVIN, Esq.
For NASD

ROBERT JENSEN, Esq.
For Wellington Management Company

EDGAR BRENNER, Esq.
For Investment Company Institute

* * * * *

[43] But, as I say, we don't think you have to reach that point.

THE COURT: So far nobody has volunteered anything from the SEC. But on the other hand, they haven't been called upon to dó so, either. I haven't had their views on anything.

All right. Thank you very much.

MR. JENSEN: Thank you, Your Honor.

THE COURT: Mr. Hunter.

MR. HUNTER: Daniel Hunter for the Government.

I will briefly touch on Section 22(d). Mr. Phil Verveer,

my colleague, will discuss Section 22(f). Carl Schwarz will then discuss both primary jurisdiction and the horizontal NASD conspiracy, and Mr. Berger will conclude the presentation.

The first thing I would like to say, Your Honor, is that we are not asking for repeal of Section 22(d), contrary to what you might have thought from the last speaker, nor if Congress in six months from now overturns the long-standing SEC interpretation, that's fine; we can do nothing about it.

What we are asking for here is the application of a principle that we think is fairly clear. And that is that statutes in derogation of the Anti-trust Laws must be construed strictly. The Supreme Court has called the Anti-trust Laws the Magna Charta of our free enterprise system in fundamental

* * * * *

[57] MR. SCHWARZ: Good morning, Your Honor. I am Carl Schwarz, appearing for the plaintiff in the Hadad case.

I would like to make four points in my alotted time.

First, each of the complaints alleges a broad industry-wide horizontal conspiracy which goes beyond the narrow immunity arguments made under 22(f) and 22(d) by the defendants.

Secondly, although we could dispose of Mr. Levin's entire argument by pointing out that nowhere does our complaint challenge a rule of the NASD, and we understand that neither the Government complaint, and presumably the grass complaint, either, are challenges of such rules directly, as well, I will show that the Maloney Act does not entitle the defendants to anti-trust immunity for such comprehensive anti-competitive agreements, because the NASD has not even attempted to follow the methods prescribed by the statute for obtaining such immunity, and the Maloney Act cannot immunize this conspiracy, in any event.

The third point is that the 1940 Act does not entitle defendants to anti-trust immunity, the so-called pervasive immunity argument, because it does not grant to the SEC discretionary power to regulate the distribution of mutual funds in the public interest, nor does it give the SEC the power to grant anti-trust immunity to cartel agreements entered into by the industry.

[Mr. Schwarz, p. 60]

[60] I would like to emphasize that 22(b) said primary distribution. It is reasonable to assume that what Congress expressly denied in 22(b), that is, power over the secondary market, could not be granted in 22(d) as the defendants argue.

I have described the Act here to emphasize that in order for the defendants to even make a colorable claim of immunity under the Maloney Act, they must show these things: First, that the plaintiffs have challenged a result of the NASD. Second, that the challenged rule was submitted to and not disapproved by the SEC, as required by the Act, which was the situation, by the way, in the Harwell case. And, three, that the rule was consistent with the specific enumerated objectives of the Act, or, as Silver, Thiel Ricci and Harwell, all cases quoted in our briefs, have stated, that whether the rule, this amounts to, those cases have stated that the rule was necessary to make the Act work.

The defendants can't even get passed No. 1. Neither we nor any of the other complaints challenge any NASD rule, no matter how much defendants would try to make it so.

What we do challenge is the informal, unofficial secret activity of the NASD designed to suffocate the secondary mutual fund market typified by but not limited to the 1958 episode disclosed by the Government brief. Defendants apparently can't bring themselves to face this issue squarely because it * * * [75] kind of conspiratorial behavior in order to make the regulatory act work. There is nothing in this record, and we submit that on the basis of the complaints that the motion to dismiss should be denied.

Thank you, Your Honor.

Mr. Brenner: Your Honor, my name is Edgar H. Brenner. I am counsel for the Investment Company Institute, one of the defendants in the Haddad civil case, not in the Government action.

I would like to hit, in rebuttal, just a few of what I regard as the particularly significant points that came up in the course of the argument by plaintiffs' counsel.

Your Honor probably noted that a remarkable and quite significant concession was made by Mr. Schwarz in which he stated that no reliance was being put in the plaintiffs' cases on NASD rules. Whereas, in the Government com-

plaint when this action was filed says specifically, under Count 2, paragraph 16 and 17, that the defendants combined and conspired with members of the NASD to establish and maintain rules which inhibit the development of a secondary market.

And, indeed, in the Government's brief, at page 64 it says specifically that the NASD established and maintained rules which inhibited the development of a secondary dealer market.

Now, as the argument of Mr. Levin pointed out, the [76] anti-trust immunity afforded to NASD action is considerable. And NASD action must be considered in terms of this comprehensive regulatory pattern which involves not just the SEC but also the NASD.

It would appear as a result of the statements of Mr. Schwarz that the plaintiffs are, in effect, abandoning a major part of the action as initially conceived.

Secondly, I think it's worthwhile to point out what has happened to the definition of the word "dealer." A new and novel, and I would suggest not very pervasive, definition was advanced dealing with the possibility of regarding people in a separate status when they are home or not working, in trying to fashion some relevance or that idea of concept to the definition of "dealer" in the Act.

We start with the proposition that under Section 22 and as a result of it, no person who is defined as a dealer who is a dealer may sell redeemable shares if they are in the process of distribution at other than the prospectus price if he is selling to the public.

The definition of "dealer" is not one that lets people easily evade that status. A dealer is a person who regularly engages in buying securities for his own account, with certain exclusions for people like banks or insurance companies. But a dealer is a person regularly engaged in the business of buying securities for his account.

* * * * *

[Daniel Levin, p. 83]

Secondly, they are on file with the SEC in the registration statement.

[83] So we are being put in the unique position of saying we are either violating state law or, in fact, we agree with the plaintiff's interpretation of 22(f), because we put these provisions in our dealer agreements and because we put them in various registration statements, there is no oc-

casion for us to put them on the certificate itself and we violate no state law by not doing so.

That is all I have, Your Honor. Thank you.

THE COURT: Mr. Schwarz, you wanted to say something further?

MR. SCHWARZ: No, Your Honor.

MR. BERGER: I just wanted to add one point in answer to the previous speaker, Your Honor. We don't complain that the defendants violated the NASD rules. We complain that they complied with the NASD rules, and that these rules aided and abetted in the consumation of the conspiracy which violated the anti-trust law.

MR. HUNTER: Just one thing in conclusion: That is, that the idea that you can just under the doctrine of primary jurisdiction secure the expertise of the SEC. That is not primary jurisdiction. We have no quarrel with seeking the expertise of the SEC by inviting them to file briefs or inviting them to file whatever they want to in the case. You [84] can have the benefit of their expertise that way.

Primary jurisdiction is a different animal. It means just what it says: jurisdiction. Does the SEC have jurisdiction over what is charged in this complaint? We maintain that they don't. We maintain that this is an anti-trust case. The SEC has decided some subsidiary issues under the Investment Company Act, but they don't have jurisdiction over the allegations of this complaint, and, therefore, the case should not be referred to them under the doctrine of primary jurisdiction.

As I say, if Your Honor desires to have them file something, we would perfectly happy to have them do so.

MR. SCHWARZ: Your Honor, if I may make another point now.

The point just raised by Mr. Hunter, I think it might be illuminating to the Court to read a one-sentence quotation from the RCA case decided by the Supreme Court, 358 U. S. page 346, where it said: "Thus, when questions arose as to the applicability of the primary jurisdiction doctrine," —I inserted that because that is what the Court was talking about—"to transactions allegedly violative of the antitrust laws, particularly involving fully regulated industries whose members were forced to charge only reasonable rates approved by the appropriate commission, this Court found the doctrine applicable," citing four or five cases including

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(Title Omitted in Printing)

MEMORANDUM OPINION

I

THE NATURE OF THE CASE

Filed, Dec. 14, 1973
James F. Davey, Clerk

Judge Corcoran

The above-captioned lawsuits are civil actions alleging violations of the federal antitrust laws in connection with the distribution of securities of open-end management investment companies ("mutual funds").[1] The operations of such companies are governed generally by the Investment Company Act of 1940 [2] (the 1940 Act).

In Civil Action No. 2454-72, plaintiff Haddad purports to sue on behalf of a class and subclass of mutual fund investors. Haddad alleges violations of the antitrust laws [Sherman Act, Sections 1-3, 15 U.S.C. §§ 1-3)] and the securities laws [Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. § 78j(b); Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1972)]. The antitrust claim is that the various defendants, including underwriters of and dealers in mutual fund shares and unnamed co-conspirators have agreed, combined and conspired to inhibit, or to refuse to participate in, transactions as agents or brokers in mutual fund shares at prices below the applicable public offering prices established in the prospectuses of such mutual funds and have placed unreasonable restraints upon the transferability of such shares. In essence, the securities claim is that there is a failure to disclose the alleged antitrust violations and that such failure constitutes an independent violation of the securities laws. Haddad alleges damages to her and her purported class of undetermined millions of dollars. Haddad's antitrust claim requests treble dam-

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[1] By definition an open-end management investment company is any issuer which (1) "is or holds itself out as being primarily . . . in the business of investing, reinvesting, or trading in securities" (15 U.S.C. § 80a-3); (2) is not a face-amount certificate company or a unit investment trust (15 U.S.C. § 80a-4); and (3) is "offering for sale or has outstanding any redeemable security of which it is the issuer" (15 U.S.C. § 80a-5).

[2] 15 U.S.C. § 80a-1, *et seq.* (1970).

ages and injunctive relief. The securities claim requests actual damages, punitive damages, and injunctive relief.

Civil Action No. 338-73 is brought by the Antitrust Division of the U.S. Department of Justice. The complaint alleges violations of Section 1 of the Sherman Act, 15 U.S.C. § 1. The gist of the complaint is that defendants National Association of Securities Dealers (NASD),[3] funds and dealers have participated in agreements, combinations, and conspiracies, the effect of which has been to inhibit a "market" for "brokerage transactions" and thereby to suppress the growth of a "secondary market in mutual fund securities," and to cause the public to pay artificial and non-competitive sales loads for mutual fund shares. The government complaint seeks only prospective, injunctive relief.

Civil Action No. 426-73, the Gross case, is another private antitrust suit and purported class action which substantially duplicates the government allegations in No. 338-73. This action seeks injunctive relief and treble damages for injury to the purported plaintiff class over an indeterminate past period.[4]

The individual defendants in each case are principal underwriters[5] or broker-dealers[6] in mutual fund shares.[7]

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[3] The NASD, incorporated in Delaware on July 18, 1939, became registered under the Maloney Act, § 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3, on August 7, 1939. National Association of Securities Dealers, Inc., 5 S.E.C. 627 (1939). It is the only association ever to have applied for or been granted registration under the Maloney Act. Its membership is comprised of some 4400 broker-dealers and principal underwriters.

[4] Since the filing of the above-captioned actions, some fifty private suits, purporting to be class actions under *Fed. R. Civ P.* 23, have been filed in various United States District Courts around the country. These cases have been transferred to this district by the Judicial Panel on Multidistrict Litigation, and are collectively cited as: In Re Mutual Fund Sales Antitrust Litigation, Civil Action No. Misc. 103-73. Pre-trial discovery and other activity in all cases (including the instant cases) has been stayed pending disposition of the motions to dismiss under consideration here.

The Court has also reserved judgment in all alleged class suits on the question of whether the actions may be maintained as class actions under *Fed. R. Civ. P.* 23.

[5] A principal underwriter is defined by the 1940 Act as

> any underwriter who as principal purchases from (an open-end investment) company, or pursuant to contract has the right . . . from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a

Additionally the NASD is named as a defendant in all three cases. In each case the defendants have moved to dismiss the complaints, pursuant to *Fed. R. Civ. P.* 12(b) on the grounds:

(a) That as a matter of law, Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(d), establishes a system of fixed, retail price maintenance in the distribution of investment company securities which is totally inconsistent with antitrust concepts and which accordingly creates, as Congress clearly intended, an exemption and immunity from antitrust liability for the defendant dealers' conduct in maintaining the fixed, public offering price of such securities;

(b) That as a matter of law, Section 22(f) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(f), sanctions contractual restrictions on the transferability or negotiability of investment company securities, subject to supervision of the Securities and Exchange Commission (SEC), which restrictions are totally inconsistent with antitrust concepts and which restrictions, therefore, as incorporated in the defendant dealers' publicly-filed investment company sales agreements, are exempt and immune from antitrust liability; and

(c) That by the Investment Company Act of 1940, Congress subjected the acts and practices of the defendant dealers in the distribution of investment company securities to continuous and pervasive regulation by the SEC as well as NASD acting under the SEC's supervision; and, accord-

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dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company. 15 U.S.C. § 80a-2(a)(29).

[6] A broker is defined by the 1940 Act as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." 15 U.S.C. § 80a-2(a)(6). A dealer is defined as "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U.S.C. § 80a-2(a)(11).

[7] The identities of all the parties in each of the above-captioned cases are reflected in the accompanying Orders.

ingly, the SEC has exclusive jurisdiction to regulate those acts and practices, and such acts and practices are exempt and immune from the claims herein alleged as violations of the Federal antitrust laws.

The motions were consolidated for argument.[8]

II

THE REGULATION OF MUTUAL FUNDS

The dispute can only be determined ultimately by an analysis of the several subsections of Section 22 of the 1940 Act and an antitrust exemption purportedly given by Section 15A(n) of the Securities and Exchange Act of 1934 (the Maloney Act) [15 U.S.C. 78o-3(n)]. Before reaching that point, however, it would seem appropriate to view the overall regulatory scheme imposed by Congress on investment companies through the 1940 Act.

It became apparent to the Congress in 1935 that the disclosure and antifraud provisions of the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act) were not adequate for the regulation of investment companies. Accordingly, it directed the SEC to make a comprehensive study of the investment company industry with a view to proposing corrective legislation. The SEC did so[9] producing a draft "Investment Trust Bill" which was the subject of hearings conducted by a Senate subcommittee.[10] Representatives of the investment company industry were invited to participate in the hearings. Ultimately a compromise bill emerged which finally

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[8] In opposition to the motions to dismiss all the plaintiffs also rely on the proposition that a complaint should not be dismissed for failure to state a claim unless it appears beyond a doubt that plaintiffs are unable to prove any set of facts which would entitle them to relief. Neither the defendants nor this Court have any argument with that general proposition, but, as the issues are drawn here for purposes of these motions to dismiss, they are strictly legal ones as to which the facts as alleged in the complaints or otherwise are not relevant.

[9] *Report of the SEC, Investment Trusts and Investment Companies, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Companies, H.R. Doc. No. 279*, 76th Cong., 1st Sess. (1939) (hereinafter cited as *Investment Trust Study of 1940*).

[10] *Hearings on S. 3580 Before a Subcomm. of Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. (1940) (hereinafter cited as *1940 Senate Hearings*).

became law as the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*[11]

The 1940 Act brought many investment companies within the disclosure requirements of the federal securities laws for the first time. It tightened up those requirements and tailored them to prohibit certain undesirable practices in the investment company industry. Presently, pursuant to the 1940 Act investment companies must register themselves (§§ 7 and 8) and their shares [§ 24(a)] with the SEC, update periodically their filings with quarterly and annual reports [§§ 30(a)-(c)], and submit prospectuses and sales literature to the SEC [§ 24(b)]. Companies must issue to their shareholders, at least semi-annually, financial reports containing specific types of information [§ 30(d)].

The 1940 Act also imposes detailed restrictions upon investment company structure, conduct, financial policies, and dealings with and by affiliates.[12]

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[11] That Act included § 22(d), one of the sections in controversy in this case, discussed *infra*. Section 22(d) prohibited sales of investment company shares to the public at any price other than the fixed public offering price.

[12] The Act delimits permissible methods for selecting directors of investment companies (and trustees in the case of investment trusts) (§ 16), sets out qualifications for securities custodians [§ 17(i)] and methods of safekeeping securities [§ 17(g)], and prohibits indemnification for official conduct [§§ 17(h) and (i)]. Certain persons guilty of prior malfeasance are barred altogether from affiliating with investment companies, advisers, custodians, and principal underwriters (§ 9). Others who commit misconduct or abuse their positions of trust can be enjoined (§ 36). Misappropriation of company funds is made a federal crime (§ 37).

The Act also sets out minimum capitalization requirements for the companies (§§ 14 and 18). It requires a majority shareholder vote for changes in a company's open-end or closed-end nature, its diversification, its capacity to borrow money, issue senior securities, underwrite others' securities, purchase and sell real estate and commodities, or make loans, its investment policies, and its fundamental business (§ 13). Certain dividend distributions are barred unless timely disclosed to the shareholders (§ 19). Investment companies are barred from participating in certain types of securities transactions [§ 12(a)] and from making certain loans (§ 21). Some proxy solicitations are barred [§ 20(a)] and some exchanges need prior SEC approval (§ 11). Reorganization plans must be submitted to the SEC, which can render a negative advisory report and seek an injunction with respect to such reorganizations (§ 25). Voting trusts and cross or circular ownership patterns are barred (§ 35). Accountants must meet certain criteria, be selected in a particular fashion, and perform certain functions (§ 32). The regulated companies must keep and refrain from destroying certain books and records (§§ 31 and 34). Unit investment trusts (§ 26) and face amount certificate companies (§§ 28-29) are given special regulatory treatment. The Act curtails the pyramiding of mutual funds [§§ 12(d)-(g)]. Unless it is

In 1938 (prior to the enactment of the 1940 Act), the Congress had amended the 1934 Act through the passage of the so-called "Maloney Act," 15 U.S.C. § 78o-3. The Maloney Act provided for the registration with the SEC of a national securities association with rule-making power upon the finding by the SEC that:

> the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.[13]

When Congress enacted the Maloney Act in 1938 it specifically provided:

> If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail. 15 U.S.C. § 78o-3(n).

The defendant NASD is the only securities association registered with the SEC under the Maloney Act.

By § 22(a) of the 1940 Act, Congress gave the NASD, as a registered national securities association, the power to promulgate rules setting the minimum price at which its members may buy redeemable fund shares from a fund, the maximum price at which its members may resell to or redeem with a fund, and the minimum period which must elapse after sale before a member may resell to or redeem

itself the principal underwriter, no investment company may acquire shares of another company whose principal underwriter is related to the first company [§ 10(f)]. At least 40% of the company's board must consist of independent directors (§ 10). Advisory contracts must first be approved by a majority of directors unaffiliated with the adviser or by a majority of shareholders [§ 15(c)]. Investment company transactions conducted by or with affiliated persons are prohibited in some cases and narrowly circumscribed in others (§ 17).

[13] § 15A(b)(8), 15 U.S.C. § 78o-3(b)(8).

with a fund. The SEC can exercise its overall supervisory power to promulgate rules superseding NASD's rules on sale, redemption and repurchase prices, holding periods, and sales loads [§ 22(c) 1940 Act].

Section 22(b)(1) of the 1940 Act empowers the NASD to adopt rules prohibiting members from charging "excessive" sales loads, provided that such rules "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters." [14] In so doing the NASD is expressly freed from a provision [15] in the Maloney Act which had prohibited it from issuing rules designed to impede "a free and open market," "fix minimum profits," "impose any schedule of prices," or "impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." Section 22(b)(3) of the 1940 Act, added in 1970, authorizes the SEC to alter and supplement the NASD's Section 22(b)(1) rules.[16] And in 1970, Congress added Section 22(b)(4) to the 1940 Act to the effect:

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a-22(b)(4).

An investment company, its principal underwriter, and its dealers are prohibited from selling redeemable securities for distribution to the public except at a current public offering price described in the prospectus [§ 22(d)]. Dealers and principal underwriters may, however, sell such securities to other dealers, the principal underwriter or the fund at other than a public offering price. (*Id.*)

An investment company may restrict the transferability and negotiability of its shares, but only insofar as that is

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[14] Before 1970, then-Section 22(b) authorized the NASD to issue rules barring "unconscionable" and "grossly excessive" sales loads, and then-Section 22(c) empowered the SEC to issue superseding rules for both NASD members and non-members.

[15] § 15A(b)(8), 15 U.S.C. § 78o-3(b)(8).

[16] The SEC may also grant qualified exemptions from NASD rules for "smaller companies" [§ 22(b)(1)]. Section 22(b)(2), another 1970 addition, gives the SEC the same rate-fixing powers over non-NASD broker-dealers as Section 22(b)(1) gives the NASD over its members. An underwriter whose shares are distributed by non-members of NASD, however, may elect to have its shares sold under the NASD rather than the SEC sales load rule. [§ 22(b)(2)].

done in conformity with the company's registration statement and not in contravention of SEC rules [§ 22(f)].[17]

By rules and regulations upon its own motion and by order upon application, the Commission may conditionally or unconditionally exempt persons, securities, or transactions, or classes thereof, from any provision in the Act or any rule or regulation thereunder, to the extent such exemption is in the public interest and not inconsistent with investor protection and the Act's purposes [§ 6(c)].[18]

Finally, no person may be held liable for any act done in conformity with an SEC rule, regulation, or order which is later invalidated [§ 38(c)].

Since 1940, the SEC has actively regulated the pricing and distribution of mutual fund shares. The Commission has promulgated a rule [19] for calculating fund share prices. It has promulgated another rule [20] allowing discount sales to certain groups and individuals and has periodically proposed [21] and adopted [22] amendments to this rule. It re-

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[17] The 1940 Act contains other provisions with respect to distribution. Redemption privileges may not be suspended or postponed for more than seven days after tender except during certain exceptional circumstances as defined by the SEC [§ 22(e)]. A fund may not issue shares for services or property other than cash or securities except as a dividend or shareholder distribution or in a reorganization [§ 22(g)]. Thus watering of shares is prevented.
Investment companies issuing periodic payment plan certificates may charge no more than a 9% sales load, nor deduct more than 50% of that load from the first year's payments, nor deduct disproportionate amounts, nor allow periodic payments of less than certain small amounts, nor make proceeds subject to management or other fees which exceed the amount the Commission prescribes as reasonable (§ 27). 1970 amendments added refund requirements and empowered the SEC to make rules with respect to reserves. (*Id.*)
Close-end funds are specially regulated with respect to watering and repurchase prices (§ 23).

[18] Baum v. Investors Diversified Services, 286 F. Supp. 914, 921 (N.D. Ill. 1968), *aff'd*, 409 F.2d 872 (7th Cir. 1969).

[19] Rule 22c-1, 17 C.F.R. § 270.22c-1, adopted in Investment Co. Act Release No. 5519 (1969), CCH *Fed. Sec. L. Rep.* '67-'69 Decisions ¶ 77,616.

[20] Rule 22d-1, 17 C.F.R. § 270.22d-1, adopted in Investment Co. Act Release No. 2798 (1958).

[21] Investment Co. Act Release No. 5507 (1968), in CCH *Fed. Sec. L. Rep.* '67-'69 Decisions ¶ 77,609; Investment Co. Act Release No. 6069 (1970) in CCH *Fed. Sec. L. Rep.* '69-'70 Decisions ¶ 77,826 and Investment Co. Act Release No. 7571 (1972) in CCH *Fed. Sec. L. Rep.* '72-'73 Decision ¶ 79,148.

[22] Investment Co. Act Release No. 6347 (1971), in CCH *Fed. Sec. L. Rep.* '70-'71 Decisions ¶ 77,953.

cently proposed a third rule [23] relating to no-load exchange privileges for fund shareholders who wish to switch to other load funds. The Commission has entertained a wide variety of applications for exemption from these rules and the relevant statutory sections and has granted some of these applications.[24] SEC administrative proceedings have barred both underpricing and overpricing of fund shares.[25]

The SEC has approved NASD Rule 26 which regulates in great detail the distribution, redemption, and repurchase of mutual fund shares.[26] The rule [27] says, *inter alia,* that principal underwriters must require their dealers to sign selling agreements containing certain restrictive provisions, that sales loads may not be "unfair," that the public offering price must be calculated in a particular fashion, that dealers and underwriters may not withhold customers orders or accumulate inventories, that certain conditional orders are barred, that the fund may not redeem at prices above net asset value, that sales loads must be refunded if the purchasers redeem soon after purchase, that fund shares may not be purchased at prices lower than the fund's next-quoted bid, and that non-contract dealers may not sell their shares back to the fund unless they are record owners of the shares. The SEC has supervised NASD enforcement

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[23] Rule 22d-2, proposed in Investment Co. Act Release No. 7555 (1972), CCH *Fed. Sec. L. Rep.* '72-'73 Decisions ¶ 79,132.

[24] See the list of more than 100 such applications in 4 CCH *Fed. Sec. L. Rep.* at p. 68,751 *et seq.* The Commission staff has issued an abundance of letters in response to "no action" requests with respect to these rules and the basic statutory provisions. From 1971 through March 21, 1973, there were 49 such letters listed in 4 CCH *Fed. Sec. L. Rep.* at pp. 63,134; 63,789; and 63,894.

[25] *See, e.g., Spiro Sideris,* Exchange Act Release No. 8816 (1970) (underpricing); *Russell L. Irish,* Exchange Act Release No. 7687 (1965), CCH *Fed. Sec. L. Rep.* '64-'66 Decisions ¶ 77,274 (overpricing). The Commission has also sought to regulate excessive "indirect" compensation to fund dealers. *E.g.,* SEC approval of new NASD Rules of Fair Practice, Section 26(k), which bars members from selling certain investment companies' shares in such a way that the companies will reciprocate with portfolio brokerage commissions, and conversely, Exchange Act Release No. 10147 (May 14, 1973), 5 *Fed. Sec. L. Rep.* ¶ 79,372.

[26] *Proposed Amendment to the Rules of Fair Practice of National Ass'n of Securities Dealers, Inc.,* 9 SEC 38 (1941).

[27] NASD Rules of Fair Practice, Article III, Section 26 in CCH NASD Manual ¶ 2176.

of this rule and reviewed NASD enforcement proceedings.[28]

For more than three decades, since the enactment of the 1940 Act, the agreements between dealers and principal underwriters, and between principal underwriters and mutual funds, have been filed with the SEC. The agreements are filed under both the 1933 Act and the 1940 Act.[29] The Investment Trust Study of 1940 described such agreements in detail.[30] The 1940 Act specifically calls for written contracts between funds and their principal underwriter [§ 15(b)]. As noted above, the Commission has approved a NASD rule which requires dealer-underwriter agreements; and Commission decisions have frequently turned on particular provisions of the dealer-underwriter agreements.[31]

III

THE OPERATION OF A MUTUAL FUND: RESALE PRICE MAINTENANCE

We look briefly at the manner in which a typical mutual fund operates within the foregoing framework.[32]

A mutual fund is an investment company which invests in the securities of other corporations and issues and has outstanding common stock representing an interest in the assets of the fund. The owner of the stock of the fund is entitled, on demand, to receive from the fund his proportionate share of the market value of the fund's net assets. To insure that the fund has sufficient cash or liquid assets on hand to meet current redemptions, the fund offers its common stock continuously. The offering price per share consists of the "net asset value" per share, computed daily,

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[28] *See* note 25 *supra*.

[29] *See* Part IV *infra*.

[30] *See* note 47 *infra* and accompanying text.

[31] *See, e.g., Mutual Funds Advisory, Inc.*, Investment Co. Act Release No. 6932 (Jan. 12, 1972); *First Multifund of America, Inc.*, Investment Co. Act Release No. 6700 (1971), CCH *Fed. Sec. L. Rep.* '70-'71 Decision ¶ 78,209 at p. 80,602; *Russell L. Irish*, Exchange Act Release No. 7687 (1965), CCH *Fed. Sec. L. Rep.* '64-'66 Decisions ¶ 77,274 at 82, 431 n.13.

[32] *See generally Investment Trust Study of 1940; Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No.* 2337, 89th Cong., 2d Sess. (1966) (hereinafter cited as *Public Policy Report*).

plus a sales charge or "load." The viability of a fund thus depends upon a distribution system which will effect continuous sales at prices which will support current redemption demands.

The primary distribution of the shares of a fund is controlled for the most part by § 22(d) of the 1940 Act and follows a basic pattern throughout the industry, *i.e.* (1) a fund enters into a contract with a principal underwriter who has the exclusive right to purchase the shares from the fund; (2) the principal underwriter acts only as a wholesaler supplying shares to retail dealers; (3) the retail dealers, who sell the shares to the investing public, are bound by contracts, commonly known as uniform sales agreements, with the principal underwriter which require that those dealers shall not sell at other than the public offering price, thus insuring that the price of the fund shares will not be the subject of competition among sellers of shares in the same fund; (4) the sales charge or "load" (which usually amounts to 7.5% to 8.5% above net asset value) is split between the underwriter and the dealer making the sale while the fund receives the net asset value component of the public offering price; and (5) when the shares are redeemed by the fund, as they must be upon demand, the redemption price is the net asset value prevailing at the time of redemption.

It is obvious from the foregoing outline of marketing procedures that the sale and distribution of mutual fund shares is accomplished through a retail price maintenance system which is patently repugnant to the free and open competition requirements of the Sherman Act. This price maintenance scheme, however, does not operate in a vacuum. Rather, it is expressly immunized from the otherwise applicable antitrust laws by virtue of the provisions of the 1940 Act and the Maloney Act. As the SEC recently reported to Congress, "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing.[33]

It has been authoritatively recognized that the Maloney

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[33] *Public Policy Report* 218-19. *See Report of the Staff of the Securities and Exchange Commission on the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* pt. I, at 1 (November 10, 1972) [hereinafter cited as *SEC Staff Report on Repeal of § 22(d)*], CCH *Fed. Sec. L. Rep.* No. 450 (Nov. 15, 1972) pt. II, at A-1.

Act, superimposed upon the regulatory scheme of the 1940 Act, provides a limited immunity for participants in the primary distribution system of mutual fund shares under SEC-approved NASD rules. That exemption [34] was noted by Mr. Justice Frankfurter in his dissenting opinion in *International Association of Machinists v. Street*, 367 U.S. 740, 809-10 n.16 (1961):

> The Maloney Act of 1938 added § 15A to the Securities Exchange Act of 1934. 52 Stat. 1070, 15 U.S.C. § 78o-3. In order to be registered, a number of statutory standards must be met. The statute specifically requires that an association's rules provide for democratic representation of the membership and that dues be equitably allocated. See § 15A(b)(5) and (6). Only one association, the National Association of Securities Dealers, Inc., has ever applied for or been granted registration. NASD membership comprises roughly three-quarters of all brokers and dealers registered with the Securities and Exchange Commission. Loss, Securities Regulation 766-67 (1951, Supp. 1955). Sections 15A(i) and (n) of the Act authorize the NASD to formulate rules which stipulate that members shall refuse to deal with nonmembers with immunity from the antitrust laws. See S. Rep. No. 1455, 75th Cong., 3d Sess. 8-9 (1938); Loss, *op. cit., supra*, 769-770. The Commission has stated that it is "virtually impossible for a dealer who is not a member of the NASD to participate in a distribution of important size." *National Association of Securities Dealers, Inc.*, 19 S.E.C. 424, 441.

Again, in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 227 n.60 (1940), Mr. Justice Douglas stated:

> It should be noted in this connection that the typical method adopted by Congress when it has lifted the ban of the Sherman Act is the scrutiny and approval of designated public representatives. Under the N.I.R.A. this could be done through the code machinery with the approval of the President as provided in §§ 3(a) and 5, *supra* note 18. Under § 407(8) of the Transportation Act

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[34] *See also* the exemption from the antitrust laws provided by § 22(b)(4):

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a-22(b)(4).

of 1920, [41 Stat. 482; 49 U.S.C. § 5(8)], carriers, including certain express companies, which were consolidated pursuant to any order of the Interstate Commerce Commission were relieved from the operation of the antitrust laws. *And see the Maloney Act (§ 15A of the Securities Exchange Act of 1934; 52 Stat. 1070) providing for the formation of associations of brokers and dealers with the approval of the Securities and Exchange Commission and establishing continuous supervision by the Commission over specified activities of such associations. . . .* (Emphasis added.)

The plaintiffs recognize a limited antitrust immunity accorded to the primary distribution system. The gravamen of their complaints, however, is that the defendants have conspired to use the primary distribution system to foreclose the development of a secondary market in mutual fund shares. This is allegedly accomplished through the use of the uniform sales agreements mentioned above, which even after the primary distribution of the shares, set the price at which the shares shall thereafter be sold, thus precluding the dealers from selling shares as brokers in a brokerage market or as dealers in a secondary dealer market in which marketplace conditions and arms-length bargaining would be the price-setting factors. The plaintiffs insist that Congress, while allowing the primary market to flourish with benefit of antitrust immunity, did not intend to foreclose secondary market growth, but that such secondary markets are in fact being discouraged and suppressed by certain NASD rules and the restrictive provisions contained in the industry-wide uniform sales agreements between principal underwriters and dealers.

IV

SECTION 22, 1940 ACT

The fact that a secondary market is to all intents and purposes nonexistent might seem to substantiate the plaintiffs' claims. However, the position of the plaintiffs fails to take into account that the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urged

upon Congress with no success. It is an economic fact, recognized by Congress, that the two markets—the primary market described in Part III *supra*, and a secondary market as urged by the plaintiffs—cannot co-exist and both remain viable. Having established a resale price maintenance system in the primary distribution system in which ordinary competitive influences cannot operate, Congress has rejected all attempts to foster a secondary market which might operate to the detriment of the primary market.

In support of those conclusions we look to the legislative history of the key sections of the 1940 Act and to the congressional intent in enacting that legislation.

A. *Section 22(d)*

Section 22(d) provides in pertinent part,

> . . . no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

As written, and as applied, that language clearly contemplates a congressionally sanctioned retail price maintenance system which is inconsistent and in conflict with the antitrust laws so far as underwriters and dealers are concerned.

Plaintiffs assert, however, that since the term "broker" or "broker-dealer" is not used in the subsection, that 22(d) permits a person to sell to another through a broker at a price less than the specified public offering price for the same shares, and that the absence of a significant brokerage market in those shares implies the existence of conspiratorial anti-competitive activity on the part of defendants to prevent the growth of that market.

This argument, however, ignores the price maintenance purpose of § 22(d) and its corollary that there must not be price discrimination between similarly situated investors.

On this latter point, so far as this Court is aware, there is no SEC or SEC staff pronouncement which can be construed to sanction price discrimination between similarly situated investors. To the contrary the SEC has said:

> The purposes of the Section [22(d)] are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a

price less than that fixed in the prospectus. Investment Company Release No. 2798 (December 2, 1958). *See also* Investment Company Release Nos. 8816 (February 13, 1970); 2718 (May 29, 1958); 89 (March 13, 1940). *See In the Matter of Investors Diversified Service,* 39 SEC 680 (1960).

Again, in its most recent annual report the SEC has stated:

> Section 22(d) precludes the sale to public investors of redeemable investment company securities which are being currently offered to the public on or through an underwriter except at a current public offering price described in the prospectus. SEC, *Thirty-eighth Annual Report* 97.

Thus, the language of the statute, its legislative history and subsequent interpretation by the SEC all indicate that its object was to allow the pre-1940 method of mutual fund share distribution to continue subject to the changes necessary to suppress what was sometimes dubbed the "bootleg" market. Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940,* 37 *U. Det. L.J.* 369, 371 (1960); *In the Matter of Spiro Sideris,* Securities Exchange Act Release No. 8816 (Feb. 13, 1970).

The legislative history of § 22 indicates that in the pre-1940 period there was in fact a secondary market in mutual fund shares, a market very similar in size and scope as that for which plaintiffs here attempt to make a case.[35] This

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[35] *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. (1940); *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. (1940); *S. Rep. No.* 1775, 76th Cong., 3d Sess. (1940); *H.R. Rep. No.* 2639, 76th Cong., 3d Sess. (1940); *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess. (1967); *Hearings on H.R. 9510 and H.R. 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 90th Cong., 1st Sess. (1967); *S. Rep. No.* 1351, 90th Cong., 2d Sess. (1968); *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency,* 91st Cong., 1st Sess. (1969); *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 91st Cong., 1st Sess. (1969); *S. Rep. No.* 184, 91st Cong., 2d Sess. (1969); *H.R. Rep. No.* 1382, 91st Cong., 2d Sess. (1970); *H.R. Rep. No.* 1631, 91st Cong., 2d Sess. (1970).

market—the "bootleg market"—was being maintained by brokers and dealers who were not under contract with the issuers or underwriters and who were not, accordingly, a part of the established distribution system of any given fund.

Those non-contract broker-dealers, without the authority of fund underwriters and in competition with authorized retail distributors of mutual fund shares, were buying shares in the market directly from shareholders at a price slightly above the published redemption price and reselling them to investors at prices lower than those fixed by the funds' principal underwriters.[36] Contract dealers operating in the primary distribution system, on the other hand, were obligated by their distribution contracts to sell fund shares at the price (including the sales charge) set by the principal underwriters.

Thus, non-contract dealers were effectively by-passing the primary distribution system and retaining for themselves the selling commissions in full.[37] If investors bought in the secondary market but redeemed through the fund, it was feared that redemptions would exceed sales of new shares and the fund would no longer have the cash available to satisfy its redemption obligations. Thus if the proceeds of new sales did not accrue to the fund, forced liquidation might result.

The congressional response to the problems of the pre-1940 market conditions was § 22. By § 22(f), *infra,* a fund was given the right to limit transferability. By § 22(d), all dealers were required to maintain the public offering price in sales to the public. The effect of the Act was for the first time to bind non-contract dealers to the public offering price. A stated purpose of § 22(d) was to insure that "no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors."[38]

This was a clear recognition that cut-price competition

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[36] *Investment Trust Study of 1940,* 865; *see also Hearings on H.R. 9510 and 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 90th Cong., 1st Sess. 59 (1967) (hereinafter cited as *1967 House Hearings*).

[37] *Investment Trust Study of 1940,* 864; *Public Policy Report* 219.

[38] *1940 Senate Hearings* 1057.

resulted in discrimination between similarly situated investors.

"Another factor in the decision to give statutory sanction to price fixing in 1940 was the fact that mutual fund distribution was then and for many years thereafter conceived of as a specialized type of underwriting, and underwriting was regarded as a field in which the law sanctioned price fixing." *1967 Senate Hearings* 153-54 (Chairman Cohen). *Cf. United States v. Morgan,* 118 F. Supp. 621, 697 (S.D.N.Y. 1953).

As alluded to *supra,* a very real danger of the "bootleg" market was that its short term price advantage would drain profits from the primary distribution system and leave the issuers unable to engage in continuous sales of new securities necessary for long-term growth and the financial health of a fund.

According to one commentator, a purpose of the price maintenance provisions was "to prevent the cut-price competition which had then been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms." Greene, *Uniform Offering Price, supra,* 37 *U. Det. L.J.* at 371.

Section 22(d) has been reconsidered by Congress several times. Its modification or repeal has been urged. Congress has consistently refused to modify or repeal it, and in the course of hearings on various proposals, the position of the SEC and the congressional intent are clearly reflected. For example, in 1967 Congress was re-examining the problems of public offering prices and sales loads. It was being urged that competition for sales loads could only be realized by a repeal of 22(d). While testifying before the Senate Committee, then-Chairman of the SEC Cohen remarked:

> However, this argument [that 22(d) be repealed to allow competition] overlooks a fundamental theme of state and federal securities regulation. Securities regulation has done a good deal for the knowledgable investors, principally by increasing the quantity and improving the quality of the information available to them. But one of its primary concerns has always been the welfare of the unsophisticated investor, who is often the one most likely but least able to bear the burden of high charges in a competitive market. If it is desirable for millions of

unsophisticated investors of modest means to invest in securities through the medium of mutual funds, it is also desirable that they should not subsequently have cause to believe that they were unfairly dealt with. On balance, we concluded therefore that a modification of the manner in which sales charges on mutual fund shares are now regulated was more consonant with the spirit and purpose of the securities laws than the elimination of Section 22(d). We therefore recommended that sales charges be limited to 5% of the amount invested, with authority in the Commission to raise this limit in appropriate situations.[39]

It is significant to note, that in the same hearings, some participants recognized that brokerage transactions, necessarily executed in the secondary market, were within the prohibition of § 22(d).

Senator Proxmire, for example, asked whether or not the SEC would recommend the repeal of 22(d) "in order to permit price competition in the sale of the same mutual fund by various broker-dealers." [40] Senator Mondale stated that section "22(d) permits—indeed makes it illegal for *agents* to sell at a sales charge less than that prescribed by the company,[41] while Professor Paul Samuelson, Massachusetts Institute of Technology, testified that "Congress should repeal the provision in section 22(d) of the Investment Company Act of 1940 which prohibits a *broker* from selling mutual fund shares to the public at less than the public offering price." [42] Later in the hearings, Senator Mondale again remarked that "Section 22(d) makes it illegal for an *agent* to charge less than his company says he must charge as an *agent's fee,* but it does not prohibit or have anything to do with competition as between companies." [43]

Similar statements appear in the House Hearings, including the following exchange between Congressman Watkins and then-SEC Chairman Cohen: [44]

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[39] *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess. 154-55 (1967) (hereinafter cited as *1967 Senate Hearings*).

[40] *Id.* 51-52.

[41] *Id.* 275 (emphasis added).

[42] *Id.* 348 (emphasis added).

[43] *Id.* 769 (emphasis added).

[44] *1967 House Hearings* 711.

Mr. Cohen. The statute now, and since 1940, interferes with competitive business in this area.

Mr. Watkins. Not to the extent you are proposing.

Mr. Cohen. I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.

Mr. Watkins. True.

In the same House Hearings, the Department of Justice, while urging the repeal of 22(d), characterized its provisions as follows:

It is true that Congress, in originally enacting the "fixed price" provisions of Section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws. In view of changed conditions, however, and the fact that the mutual funds are so important an outlet for the small investor, it would seem that he should not perhaps be deprived of the opportunity of purchasing his investment at a price arrived at through the free operation of competitive forces.[45]

The SEC took the same view. The then-Chairman Cohen stated that "sellers of mutual fund securities have been insulated by Federal Law from price competition at the retail level ever since 1940" (*1967 Senate Hearings* 26), and that § 22(d) "provides an exemption from the antitrust laws" (*1967 House Hearings* 140). Furthermore, the SEC's view that § 22(d) requires retail price maintenance by broker-dealers who are members of the primary distribution system is also evident in its acceptance of NASD Rule 26(e), which provides that "no member shall offer or sell any such security except at the effective public offering price described in the current prospectus of the issuing company. . . ." CCH NASD Manual ¶ 2176.

The same thread runs through hearings conducted in 1969,[46] again with a view to the modification or repeal of

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[45] *Id.* 21 (letter from Warren Christopher, Deputy Attorney General, to Chairman Harley O. Staggers, October 18, 1967).

[46] *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. (1969); *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. (1969).

§ 22(d). In the 1969 Senate report, we find these comments on § 22(d):

> The provision for "reasonable loads to investors" is intended to assure that the sales loads fixed by the principal underwriters (*which continue to be protected against price competition by Section 22(d) of the act*) will be established at levels which recognize the interests of investors.
>
> The provisions of this proposed section shall prevail over any conflicting provision of Federal law. This provision, *which is identical to Section 15A(n) of the Securities Exchange Act, is designed to make it clear that no other provision of Federal law, including the antitrust laws,* prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section. *S. Rep. No.* 184, 91st Cong., 1st Sess. 18 (1969) (emphasis added).
>
> The basic sales commission charged for mutual fund shares is in most instances about 8½ percent of the total payment or 9.3 percent of the amount invested. *This charge is protected by Section 22(d) of the Investment Company Act which provides for a unique scheme of retail price maintenance. Under this section, all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime.*
>
> In its deliberations your committee considered the possibility of deleting Section 22(d) from the act. However, impressive testimony was given that there had not been sufficient study of the consequences of such an amendment. Therefore, your committee requests the Securities and Exchange Commission to review the consequences of such a proposal on both the investing public and mutual fund sales organizations and report to it as soon as is reasonably practicable. *Id.* 7-8 (emphasis added).

It is thus conclusively established that competition in the sale of a single fund's shares is effectively precluded by the 1940 Act which was intended, via § 22(d), to prevent the sale of fund shares at a price less than that fixed in the current prospectus. It is obvious that Section 22(d) of the 1940 Act was premised upon a congressional understanding that principal underwriters and broker-dealers were exempt

from the antitrust laws when entering into uniform sales agreements for mutual fund shares. It is also obvious that even at the expense of a secondary market Congress intended to maintain the resale price maintenance system. Congressional intent is entitled to substantial weight lest this Court "change the design that Congress fashioned." *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 458 (1962).

B. *Section 22(f)*

Section 22(f) is a necessary companion to § 22(d). If the problems of the competitive market created by non-contract brokers were to be met, restrictions on alienability were necessary. And Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Paraphrased, that language states clearly that if (1) restrictions on transferability or negotiability are included in the registration statement, and if (2) these restrictions are not in contravention of such rules and regulations as the commission may prescribe in the interest of the shareholders, then such restrictions are permissible even if they create departures from antitrust standards.

As noted above in the discussion of § 22(d), Congress considered the 1940 Act in the light of then-existing conditions, particularly the disruptive influence upon the market in mutual fund shares by the practices of non-contract dealers and brokers.

To overcome this disruptive competition prior to the enactment of the 1940 Act, some funds restricted the alienability of their shares, "providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company." [47] Such restrictions were usually included in the share certificates.[48]

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[47] *Investment Trust Study of 1940*, 865.

[48] *1940 Senate Hearings*, 292 (remarks of SEC General Counsel David Schenker).

From and after 1940, § 22(f) required that any restriction on alienability be included in the registration statements and, additionally, that they be subject to the rule-making authority of the SEC. Clearly, by § 22(f) Congress specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rule-making authority of the SEC. Just as clearly Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications.

Restrictions on alienability have consistently appeared in registration statements and in uniform sales agreements since the passage of the 1940 Act. Not only are such contracts required by SEC-approved Rule 26 of the NASD Rules of Fair Practice, CCH NASD Manual ¶ 2176, but they are also disclosed in the registration statements. It is undisputed that these agreements have remained virtually unchanged since they were first filed with the SEC along with and as part of the registration statements. It is also undisputed that the SEC has never challenged the validity of uniform sales agreements. Indeed, the SEC has noted that these agreements require a dealer "to place all orders with the principal underwriter and to refrain from any attempt to obtain shares from other sources." [49]

It is thus apparent that Congress designed §§ 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is "incompatible with the maintenance of (an) antitrust action." *Silver v. New York Stock Exchange*, 373 U.S. 341, 358 (1963).

Whether the mutual fund marketing structure mandated by Congress in 1940 should be eliminated or modified is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide. In fact, in urging its complaint upon

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[49] *SEC Staff Report on Repeal of § 22(d)* A-109. *See Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No.* 95, 88th Cong., 1st Sess. 98 (1963), wherein reference is made to the "fair trade arrangements established by the Act, the NASD rules and private sales agreements . . ."; Greene, *Uniform Offering Price*, *supra*, 37 *U. Det. L.J.* at 371-72.

the Court, one of the plaintiffs, *viz.*, the Department of Justice, seeks to accomplish indirectly what it has failed, so far, to achieve directly—the repeal or modification of § 22(d)—in hearings before both Congress [50] and the SEC.[51]

V
IMPLIED IMMUNITY

Even if a specific exemption granted by the Maloney Act were deemed to be inadequate to grant immunity from the impact of the antitrust laws, the defendants urge that the 1940 Act, particularly § 22 thereof, created a pervasive regulatory scheme which highlighted the Congressional intent to immunize the investment company industry from the impact of the antitrust laws.

The plaintiffs, on the other hand, urge that repeals of the antitrust laws by implication are "strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." They argue that, in the instant case, plain repugnancy is not apparent.

The most recent pronouncement of the Supreme Court on this particular point is to be found in *Hughes Tool Company v. Trans World Airlines*, 409 U.S. 363 (1973).

In *Hughes Tool* the respondent TWA challenged as violative of the antitrust laws certain transactions and activities of petitioner Hughes Tool (Hughes). The Supreme Court, dismissing the action, held that the challenged transactions "were under the control and surveillance of the Civil Aeronautics Board" (CAB); that pursuant to the Federal Aviation Act of 1968 the CAB applying antitrust standards has reviewed the same kind of conduct which TWA alleged to be violative of the antitrust laws. The Court stated:

> In this context, the authority of the Board to grant the power to "control" and to investigate and alter the manner in which that "control" is exercised leads us to conclude that this phase of CAB jurisdiction . . . pre-

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[50] *1967 House Hearings.*

[51] *In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940*, SEC File No. 4-164 (1973).

> empts the antitrust field. 409 U.S. at 385 (footnote omitted).

And the Court further stated that where

> the CAB authorizes control of an air carrier to be acquired by another person or corporation and where the CAB specifically authorizes as in the public interest specific transactions between the parent and the subsidiary, the way in which that control is exercised in those precise situations is under the surveillance of CAB, not in the hands of those who can invoke the sanctions of the antitrust laws. 409 U.S. at 387.

Further the Court said that its holding was "consistent with the view expressed in *Silver v. New York Stock Exchange* . . . that a statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances *by implication* grant immunity from an antitrust claim." 409 U.S. at 385 n.14 (emphasis added).

The Court in *Hughes Tool* relied heavily on its prior decision in *Pan American World Airways v. United States,* 371 U.S. 296 (1963), which also involved the pervasive regulatory scheme of the CAB and an implied repeal of the antitrust laws. In *Pan American* the Court found that the Sherman Act could not be applied to matters which the CAB had approved in exercising its statutory function.

> It would be strange, indeed, if a division of territories or an allocation of routes which met the requirements of "public interests" as defined in § 2 were held to be antitrust violations. . . . If the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide. 371 U.S. at 309-10.

The Court then found that the implementation of antitrust policy in the public interest was for the CAB, under the Federal Aviation Act's comprehensive regulatory scheme, and not for the courts. In the case at bar, as in *Hughes Tool* and *Pan American,* there exists a pervasive regulatory scheme coupled with a legislative history manifesting congressional intent to immunize the investment company industry from the operation of the antitrust laws to the limited extent necessary to carry out the purpose of the independently defined federal policy legislated in the

regulatory act, *i.e.*, the Investment Company and Maloney Acts.[52]

The decisions in *Hughes Tool* and *Pan American* are consistent with the views expressed in *Silver v. New York Stock Exchange, supra,* where the Supreme Court held that the Stock Exchange was not exempt from the antitrust laws when, pursuant to its rules, it ordered its members to remove certain telephone connections they had with the offices of a non-member. Although the Exchange was generally regulated by the Securities Exchange Act of 1934, the Court noted that the SEC lacked jurisdiction to review cases such as petitioner's where the Exchange has enforced its rules. *Silver v. New York Stock Exchange, supra,* 373 U.S. at 358.

The Court's opinion in *Silver* turned on the fact that there was no justification for the Exchange rule under the Securities Exchange Act because that rule did not provide any procedural safeguards for the petitioner. The Court did find, however, that "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." 373 U.S. at 361. The Court noted further that "(s)hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, *supra.*" 373 U.S. at 360. The Court's reference, "note 12," refers expressly to the SEC's jurisdiction under the Maloney Act and states that were there such SEC jurisdiction in a *Silver*-

[52] In Hecht v. Pro-Football, Inc., 144 U.S.App.D.C. 56, 444 F.2d 931 (1971), *cert. denied,* 404 U.S. 1047 (1972), the Court held the following to be relevant criteria for determining which conduct is immune from the antitrust laws:

> Putting the problem in this light, relevant criteria would include the specific language of the congressional statute involved, any legislative history which would throw light on the congressional intent, the relative importance of the governmental action which is asserted to override antitrust policy, whether the governmental agency is required to take into consideration the possible anticompetitive effect of its actions, whether the agency is required to adhere to a clearly defined and restricted statutory directive, and to what extent the agency's actions are subject to judicial review. 144 U.S.App.D.C. at 60, 444 F.2d at 935.

See also Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264, 270 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971), where the Court also discussed immunity criteria; United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953).

type situation, "a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity . . ." 373 U.S. at 358 n.12.[53]

This Court is persuaded that the instant case is that "different case."[54] The Investment Company Act and the Maloney Act read together demonstrate that Congress intended to eliminate free competition in the distribution of mutual fund shares. The language of both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency.[55] The SEC and the NASD have the statutory authority to control the area and both have in fact taken an active role. The NASD, under the control and supervision of the SEC, has adopted specific rules to govern the activities of principal underwriters and broker-dealers. The Maloney Act, Section 15A(b)(8), specifically requires the SEC to employ antitrust standards, *i.e.*, "to protect the public interest," when reviewing the rules promulgated by the NASD.[56] Still further, the SEC has adopted rules

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[53] *But see* Harwell v. Growth Programs, Inc., 451 F.2d 240 (5th Cir. 1971), *reh. denied*, 459 F.2d 461, *cert. denied*, 409 U.S. 876 (1972), where the Court applied the *Silver* rationale to self-regulatory activities of the NASD. *Harwell*, however, did not involve a claim of limited antitrust immunity under § 22 of the 1940 Act.

[54] *Cf.* Gordon v. New York Stock Exchange, Inc., *et al.*, Civil No. 71-1496 (S.D.N.Y., filed Dec. 4, 1973), where the Court, in dismissing an antitrust attack on the commission structure of both the New York and American Stock Exchanges, found that the fixing of commissions falls within the congressional policy of exchange self-regulation embodied in the Securities Exchange Act of 1934.

[55] In Baum v. Investors Diversified Services, Inc., 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd on other grounds*, 409 F.2d 872 (7th Cir. 1969), the plaintiff alleged a violation of the Robinson-Patman Act. After reviewing the SEC involvement, the court held:

> The foregoing demonstrates that the SEC has exercised its broad regulatory authority in this industry to establish a framework of pricing practices within which investment companies must operate. It has specifically approved the alleged discriminatory pricing system under attack in the case at hand, and has justified the system as being "in the public interest and consistent with the protection of investors and purposes fairly intended by the policy and provisions of this Title." 286 F. Supp. at 924.

[56] *See also* Section 6(c) of the 1940 Act which empowers the SEC to "exempt any person, security, or transaction . . . from any provision" of the Act "if and to the extent that such exemption is necessary or appropriate in the *public inter-*

specifically designed to govern *non*-NASD members in the distribution and redemption of mutual fund shares. *See* 15 U.S.C. §§ 78o(b)(8)-(10). In connection with its regulatory function, the SEC has extensively reviewed the distribution and redemption practices in the investment company securities industry and even has reviewed the secondary market for such securities.[57]

This Court's opinion is further strengthened by the Supreme Court's decision last Term in *United States v. Cartwright,* 411 U.S. 546 (1973). That case challenged a regulation issued by the Secretary of the Treasury covering valuation of mutual fund shares for Federal Estate Tax purposes. The Court at least impliedly recognized the pervasive regulatory scheme in the investment company industry.

> Private trading in mutual fund shares is virtually nonexistent. Thus at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund, at the "asked" price, which includes the load. But shareholders "sell" their shares back to the fund at the *statutorily* defined redemption or bid price. 411 U.S. at 549 (emphasis added).

The Court went on to state that the regulation in question was "manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operates without regard for the market in mutual fund shares that the Act *created and regulates.*" 411 U.S. at 557 (emphasis added).

The plaintiffs place great reliance on other recent Supreme Court decisions. Principally they rely upon *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973), in which the Court refused to imply immunity from the antitrust laws. Plaintiffs cite *Otter Tail* to show that even ex-

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est and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. 15 U.S.C. § 80a-6(c) (emphasis added).

[57] *See, e.g., Public Policy Report; SEC Staff Report on Repeal of § 22(d); In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940,* SEC File No. 4-164 (1973).

tensive regulation of an industry does not thereby immunize that industry from the antitrust laws. The Court's language is clear and unequivocal, however, for it found congressional intent *not* to displace the antitrust laws, but rather to retain the applicability in order to promote competition. That is not the case here.

> It is clear, then, that *Congress rejected a pervasive regulatory scheme for controlling the interstate distribution of power in favor of voluntary commercial relationships. When these relationships are governed in the first instance by business judgment and regulatory coercion,* courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws. *See United States v. Radio Corporation of America, supra,* at 351. This is particularly true in this instance because Congress, in passing the Public Utility Holding Company Act, . . . was concerned with "restraint of free and independent competition" among public utility holding companies. See 15 U.S.C. § 79a(b)(2). 410 U.S. at 374 (emphasis added).

Otter Tail accordingly is not controlling.

Nor does *Federal Maritime Commission v. Seatrain Lines, Inc.,* 411 U.S. 726 (1973) support plaintiffs' position. That case dealt with the scope of an express repealer of the antitrust laws in the 1916 Shipping Act [58] which by its terms, limited antitrust immunity to conference agreements approved by the Federal Maritime Commission (FMC). At issue was whether an agreement which confers no ongoing obligations is an "agreement" within the meaning of the Act. The Court held that Congress did not intend to invest the FMC with the power to shield from antitrust liability mergers which create no continuing responsibilities. Furthermore, the Court found in examining the legislative history there was an overriding federal policy to promote competition. Since the FMC's power to immunize agreements from the antitrust laws was limited only to those agreements approved by it, this Court fails to see in what manner the claim for limited immunity in the present case

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[58] 46 U.S.C. § 814. See Note, *The Shipping Industry Seeks a Safe Haven: Merger Jurisdiction for the FMC?*, 5 *Law & Pol. Int'l Bus.* 274 (1973).

offends the *Seatrain* principle since there is no similar requirement conditioning exemptions in the 1940 Act.[59]

This Court is not, of course, unmindful of the fact that "(r)epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." *United States v. Philadelphia National Bank,* 374 U.S. 321, 350-51 (1963) (footnotes omitted). *See also United States v. McKesson & Robbins, Inc.,* 351 U.S. 305, 316 (1956); *California v. FPC,* 369 U.S. 482 (1962); *United States v. Borden Co.,* 308 U.S. 188 (1939). That principle, of course, rests upon the sound basis that "antitrust laws represent a fundamental national economic policy." *Carnation Co. v. Pacific Westbound Conference,* 383 U.S. 213, 218 (1966).[60] With that fundamental policy in mind, the Court does not hold that the Investment Company Act and the Maloney Act "completely displace the antitrust laws." *Hughes Tool, supra,* 409 U.S. at 389. What the Court does find is a "limited antitrust exemption." *Carnation Co., supra,* 383 U.S. at 219. Here, given the fact that Congress clearly intended to substitute a pervasive regulatory scheme, *i.e.,* § 22 of the 1940 Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is clear that the price maintenance practices complained of are immune from ordinary antitrust strictures.[61]

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[59] *Cf.* Ricci v. Chicago Mercantile Exchange, 409 U.S. 289, 302-03 n.13 (1973), where the Court recognized that where a regulatory act contains an express exemption from the operation of the antitrust laws, or where a regulatory agency is specifically directed to consider competitive factors in the exercise of its duties, it is necessary to conclude that Congress intended to exempt from the antitrust laws activity subject to the administrative agency's adjudicative or rule-making authority.

Moreover, the cases at bar do not involve the doctrine of primary jurisdiction. *See, e.g.,* Chicago Mercantile Exchange v. Deaktor, 42 U.S.L.W. 3330 (U.S. Dec. 3, 1973) (No. 241); Ricci v. Chicago Mercantile Exchange, *supra.*

[60] *See, e.g.,* United States v. Borden Co., 308 U.S. 188, 200 (1939). *Cf.* Maryland & Virginia Milk Producers Ass'n Inc. v. United States, 362 U.S. 458 (1960).

[61] Notwithstanding this conclusion, two SEC rulings, cited by plaintiffs in support of their contention that the price maintenance requirements of § 22(d) would not apply if the broker-dealer acted in the capacity of a broker rather than a dealer, deserve mention. One is an Opinion of SEC General Counsel, Investment Company Act Release No. 87 (March 14, 1941). In response to an abstract inquiry, the General Counsel thought that the term "dealer" in § 22(d)

VI

CONCLUSION

In light of the foregoing, the Court concludes that the plaintiffs in each of the above-captioned cases have failed to state a claim upon which relief can be granted, and that accordingly the motions to dismiss in each such case must be granted. Orders are filed herewith.

Dated: December 14, 1973

/s/ ....

JUDGE

Dated: December 14, 1973

"refers to the capacity in which a broker-dealer is acting in a particular transaction." He concluded that when a broker-dealer acts as a broker in a specific transaction, he is not bound to sell at the public offering price. In the Matter of Oxford Co., Inc., 21 SEC 681 (1946), involved a disciplinary proceeding for a broker-dealer alleged to have violated his fiduciary duty to his clients. There the broker-dealer sold mutual fund shares from one of his accounts to another related account, charging the public offering price and retaining the sales load for himself. The SEC, citing the General Counsel's opinion, rejected the technical defense that the subject's actions were mandated by § 22(d).

The Court concludes that reliance on these two decisions is misplaced. They are *ad hoc* decisions in no way related to the regulated distribution system. Furthermore, they do not address the problem of likely discrimination between similarly situated investors. Such shortcomings preclude a basis for allowing industry-wide cut-price competition in brokerage transactions contrary to the purposes of § 22(d).

(Title Omitted in Printing)

NOTICE IS HEREBY GIVEN that the United States of America, plaintiff herein, appeals to the Supreme Court of the United States from the judgment for defendants entered December 14, 1973.

This appeal is taken under the Expediting Act, 15 U.S.C., Sec. 29.

Dated at Washington, D. C., February 11, 1974.

/s/ Daniel R. Hunter
DANIEL R. HUNTER
Attorney for Plaintiff

(Certificate of Service Omitted in Printing)

SUPREME COURT OF THE UNITED STATES

No. 73-1701

UNITED STATES, *Appellant*,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al.*

APPEAL from the United States District Court for the District of Columbia.

The statement of jurisdiction in this case having been submitted and considered by the Court, probable jurisdiction is noted.

October 15, 1974

☆ U.S. Government Printing Office: 1975—567-377/98

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In the Supreme Court of the United States

OCTOBER TERM, 1973

No.

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

JURISDICTIONAL STATEMENT

OPINION BELOW

The memorandum opinion of the district court (App. A, *infra*, pp. 29–68), accompanying its order of dismissal (App. B, *infra*, pp. 69–70), is not yet officially reported.

JURISDICTION

The memorandum opinion and order of the district court were entered on December 14, 1973. The notice of appeal to this Court (App. C, *infra*, p. 71) was filed on February 11, 1974. On March 14, 1974, the Chief Justice extended the time for docketing the

appeal to May 13, 1974. The jurisdiction of the Court is conferred by Section 2 of the Expediting Act, 15 U.S.C. 29. *United States* v. *Shubert,* 348 U.S. 222; *United States* v. *New Wrinkle, Inc.,* 342 U.S. 371.

QUESTIONS PRESENTED

The Investment Company Act of 1940 imposed a variety of restrictions upon the sale, distribution and redemption of mutual fund shares. The Act also gave specified regulatory authority over the mutual fund industry to the Securities and Exchange Commission and to associations of securities dealers registered by the Commission pursuant to the Maloney Act of 1938. Open-end mutual fund shares are sold through a principal underwriter who distributes them to broker/dealers, most of whom are members of the only registered association. Section 22(d) of the Investment Company Act permits the fund to specify the price at which its shares may be sold by the fund, its principal underwriter, or dealers to investors or persons other than a principal underwriter or a dealer. Section 22(f) prohibits a mutual fund from restricting the transferability or negotiability of its shares except in conformity with an applicable registration statement and such rules as the Commission may have adopted.

The questions presented are:

1. Whether the resale price maintenance required in primary distribution by Section 22(d) also by implication exempts from the antitrust laws combinations and agreements to suppress competition in secondary markets for outstanding mutual fund

shares involving sales between dealers or sales between investors made through brokers.

2. Whether Section 22(f) creates an exemption from the antitrust laws for such combinations and agreements.

3. Whether the Investment Company Act and the Maloney Act create a regulatory scheme so pervasive that it impliedly exempts all possible restraints in the distribution and sale of mutual fund shares.

STATUTES INVOLVED

Section 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, provides in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal * * *.

Section 22(d) of the Investment Company Act of 1940, 54 Stat. 824, as amended, 15 U.S.C. 80a-22(d), provides in pertinent part:

> No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. * * *

Section 22(f) of the Investment Company Act of 1940, 54 Stat. 824, as amended, 15 U.S.C. 80a–22(f), provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

STATEMENT

This is a direct appeal from a judgment of the district court dismissing prior to discovery or trial a civil antitrust action filed by the United States under Section 1 of the Sherman Act, 15 U.S.C. 1. The defendants are the National Association of Securities Dealers, Inc. ("NASD") and certain mutual funds,[1] mutual fund underwriters,[2] and securities broker/dealers.[3] The complaint alleged that the appellees have combined and agreed to restrict the sale and/or fix resale prices of the shares of open-end mutual

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[1] Massachusetts Investors Growth Stock Fund, Inc.; Fidelity Fund, Inc.; and Wellington Fund, Inc.

[2] The Crosby Corporation; Vance, Sanders & Company, Inc.; and The Wellington Management Company, Inc.

[3] Merrill Lynch, Pierce Fenner & Smith, Inc.; Bache & Company, Inc.; Reynolds Securities Corp.; F. I. duPont, Glore Forgan, Inc.; E. F. Hutton, Inc.; Walston & Company, Inc.; Dean Witter & Company, Inc.; Paine, Webber, Jackson & Curtis, Inc.; and Hornblower & Weeks—Hemphill, Noyes, Inc.

funds in transactions between dealers[4] ("the inter-dealer market") and in transactions between investors made through a broker ("the brokerage market") in violation of the antitrust laws.

THE MARKETS FOR OPEN-END MUTUAL FUND SHARES

This case involves alleged restraints on the trade and commerce in open-end mutual fund shares, an industry described in detail in the complaint (¶¶3, 9-14). A mutual fund is an investment company which invests in the securities of other corporations. An "open-end" company or fund is one which issues "redeemable securities," *i.e.,* common stock representing an interest in the assets of the fund, the owner of such stock or "shares" being entitled, on demand, to receive from the fund his proportionate share of the fund's current net assets or the cash equivalent thereof. See 15 U.S.C. 80a-2(a)(32).

Typically, in their initial or primary distribution, open-end mutual fund shares are distributed through a principal underwriter (often an affiliate of the fund) to dealers with whom the underwriter has sales agreements, and the dealers sell to investors. Under

[4] Under the Investment Company Act of 1940, a "dealer" is "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise * * *" (15 U.S.C. 80a-2(a)(11)), and a "broker" is defined as "any person engaged in the business of effecting transactions in securities for the account of others * * *." 15 U.S.C. 80a-2(a)(6). The term "broker/dealer" is not defined in the Act but is used generically and applies to firms which engage in securities transactions in the capacity of either a "broker" or a "dealer."

Section 22(d) of the Investment Company Act of 1940 (15 U.S.C. 80a–22(d)), fund shares may be sold in this initial distribution to investors only at the "current public offering price." This price is equal to the prorated net asset value of the fund's portfolio plus a sales commission or "load," which is divided between the principal underwriter and the dealer.[5] An investor wishing to dispose of his shares normally does so by tendering them to the fund, which is obliged to pay him the proportionate current net asset value of his shares. Shares may also be redeemed through dealers.

A "secondary dealer market" in mutual fund shares includes an inter-dealer market and a market in which dealers purchase outstanding shares from investors, possibly at more than the redemption price, and resell to investors at the fund's "current public offering price." A "brokerage market" in mutual fund shares is one in which outstanding shares are transferred between investors acting through broker/dealers in a brokerage transaction.

Many aspects of the primary distribution of mutual fund shares are regulated by the Investment Company Act of 1940, 15 U.S.C. 80a–1, *et seq.* In addition, most broker/dealers are members of the defendant NASD, which is the only national securities association that has been registered with the Securities and Exchange Commission ("SEC") pursuant to the Maloney Act of 1938 (15 U.S.C. 78*o*–3). That Act authorizes such

[5] Sales loads are typically between 7.5 percent and 8.5 percent of the offering price; 1.5 percent usually goes to the principal underwriter, with the balance going to the dealer.

a registered association to engage, by adoption and enforcement of rules, in a degree of self-regulation, subject to specified review by the Commission. The Maloney Act provides that its provisions prevail over any prior law in conflict therewith. 15 U.S.C. 78*o*–3(n). The Investment Company Act further provides that an association registered under the Maloney Act may adopt rules governing limited aspects of the distribution and redemption of mutual fund shares. 15 U.S.C. 80a–22(a), (b) (1).

B. THE ANTITRUST VIOLATIONS ALLEGED IN THE COMPLAINT

The complaint alleges in Count I that the appellee NASD and its members (including the appellee broker/dealers and underwriters) have combined and conspired to restrain trade in the purchase and sale of mutual fund shares through a conspiracy, "the substantial terms of which have been, and are, to prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares" (Compl. ¶¶ 15–16).

Among the things appellees allegedly did to effectuate the conspiracy were to (a) establish and maintain rules which had the effect of inhibiting the development of the secondary dealer and brokerage markets; (b) induce broker/dealers and principal underwriters to enter into restrictive sales agreements designed to suppress the development of such markets; (c) distribute misleading information concerning the legality of a brokerage market and discourage persons

from participating in it; and (d) suppress market quotations for the secondary dealer market.

In addition, Counts II–VIII alleged that the appellee mutual funds and their principal underwriters and broker/dealers have "entered into and maintained contracts and combinations * * * in unreasonable restraint of the aforesaid trade * * *" (Compl. ¶¶ 22, 28, 34, 40, 46, 52 and 57), consisting of specific contractual agreements between the broker/dealers and principal underwriters ("sales agreements") and between the principal underwriters and their respective mutual funds ("underwriting agreements"). The sales agreements, the complaint alleged, contain restrictive provisions directed towards prohibiting the participation of the broker/dealer in competitively-priced brokerage or interdealer markets. The underwriting agreements were alleged not only to prohibit the principal underwriter from participating in transactions in the secondary markets, but also, in one instance, to obligate the principal underwriter to require that broker/dealers, in turn, agree to such restrictions.

In consequence, it is alleged, the purchase and sale of open-end mutual fund shares have largely been confined to the primary distribution system; secondary markets have been eliminated or curtailed;[6] where

[6] Although the record contains no evidence, due to the dismissal of the complaint, it is undisputed that as a practical matter no brokerage market exists currently and the interdealer market is insignificant, apparently having accounted for less than one-tenth of one percent of total share sales in 1970. SEC Staff Study. *On the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* A-113 (1972).

secondary brokerage transactions have been permitted by certain funds, the prices at which such transactions occur have been illegally fixed; and the public has been deprived of the benefits of free and open competition in a secondary dealer market and a brokerage market in mutual fund shares.

The complaint seeks a variety of injunctive relief against continuation of the alleged violations and perpetuation of their effects.

C. THE DISTRICT COURT'S DECISION

On motions by the appellees filed before discovery and trial, the district court dismissed the government's complaint for failure to state a claim upon which relief could be granted.[7] First, the court held that "Congress designed §§ 22(d) and 22(f) [of the Investment Company Act] to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market" (App. A, *infra*, pp. 40–58). The court noted that prior to the passage of the Investment Company Act, a secondary market in open-end mutual fund shares had existed—the so-called "bootleg market." Sections 22(d) and 22(f),

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[7]At the same time the court also dismissed complaints filed by private investors against most of the same defendants making similar allegations and seeking treble damages and injunctive relief. *Haddad* v. *Crosby Corp.*, Civ. No. 2454–72 (D.D.C.); *Gross* v. *National Ass'n of Secs. Dealers, Inc*, Civ. No. 426–73 (D.D.C.). Those dismissals have been appealed to the United States Court of Appeals for the District of Columbia Circuit.

the court said, were aimed at suppressing the "cut-price competition" in this market which had caused "discrimination between similarly situated investors" (App. A, *infra*, 48–50, 56–57).

Second, the district court held that the "pervasive" regulatory scheme of the Investment Company Act (15 U.S.C. 80a–1, *et seq.*) and the Maloney Act (15 U.S.C. 78*o*–3) was intended to replace the "usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares" (App. A, *infra*, pp. 56–57). In the court's view, Congress intended that supervision and control of this complex area should be committed exclusively to the regulatory authority of the Securities and Exchange Commission, under the Investment Company Act, and to the self-regulatory power of the NASD, subject to Commission supervision and review, under the Maloney Act.

THE QUESTIONS ARE SUBSTANTIAL

This appeal presents important questions involving the application of the antitrust laws to the multi-billion-dollar mutual fund industry, which has developed a distribution system that effectively prohibits any competition in the sale and redemption of its shares following the initial distribution of such shares to the public. The restraints alleged in the complaint ordinarily would constitute a *per se* violation of Section 1 of the Sherman Act. The basic question in this case is whether the regulatory scheme which Congress created for this industry was intended to exempt from the antitrust laws all transactions in mutual fund shares

subsequent to their initial distribtuion. We submit that it was not.

In Section 22(d) of the Investment Company Act, Congress provided a narrow exemption from the antitrust law: open-end mutual funds may engage in resale price maintenance by fixing the prices at which dealers sell their shares to the public while a primary distribution of such shares is under way. We submit, however, that neither in Section 22(d) nor in Section 22(f) did Congress permit horizontal price fixing. Funds may not set prices in a secondary brokerage market, and Congress did not sanction agreements among dealers through their trade association to eliminate competition in the sale and redemption of outstanding shares. If secondary brokerage and inter-dealer markets were given the opportunity to develop free of the restraints defendants have imposed, investors would have the alternative of price competition in both the purchase and the sale of mutual fund shares that had previously passed through the primary distribution chain.[8] Secondary markets exist for virtually all other transferable securities. If investors wish to take advantage of such markets, there is no reason why mutual fund shares should be an exception.

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[8] The potential role of secondary markets is described in a recent report. See SEC Staff Study, *supra*, at A-111 to A-113, A-120 to A-121. A few dealers currently make markets in the most widely-held mutual fund shares. Other dealers with customers wishing to acquire or liquidate shares can go to these firms and avoid dealing with the fund itself and the principal underwriters. This market does not produce any monetary advantage to a "buying" investor, since all dealer sales to investors, under Section 22(d), must be made at the fixed public offering price so long as the same class of share is being offered to

In extending the limited antitrust immunity of Section 22, the district court departed from the well-established doctrines that exemptions to the antitrust laws must be narrowly construed and that an exemption from those laws for industry self-regulation may be implied only to the minimum extent necessary to make the regulatory system work. *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321; *Silver* v. *New York Stock Exch.,* 373 U.S. 341; *United States* v. *McKesson & Robbins, Inc.,* 351 U.S. 305.

1. In ruling on the defendants' motions to dismiss the complaint prior to discovery or trial, the district court's function was "necessarily a limited one" of determining whether there were no facts the govern-

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the public by the fund or its underwriter. (Such a primary distribution of mutual fund shares is usually, but not always, continuous in nature. See SEC Staff Study, *supra*, at A–118.) It can, however, produce an advantage to "selling" investors because a dealer may be willing to pay more than net asset value for the shares. (The principal underwriter's 1.5 percent spread (see p. 6, *supra*, n. 5), which is avoided in the inter-dealer market, offers one opportunity for dealers to pay selling investors small increments above net asset value without cutting into their own commission income.) In addition, the inter-dealer market may permit selling investors to dispose of their shares more quickly and easily than would be the case were the investor required to redeem them through the fund or its underwriter.

Another secondary market for the purchase and sale of open-end mutual fund shares would be a "brokerage market" in which investors could sell to one another using broker/dealer firms acting in the capacity of brokers as intermediaries. The buying and selling investors would be free to negotiate a price between the public offering price (which includes the sales load) and the net asset value (at which the fund is required to redeem) of the shares being transferred, thereby benefiting both parties to the transaction.

ment might prove under the broad allegations of the complaint that would entitle it to relief. *Scheuer* v. *Rhodes,* No. 72–914, decided April 17, 1974, slip op. 4; cf. *Poller* v. *Columbia Broadcasting Sys., Inc.,* 368 U.S. 464, 472–473.[9] Accordingly, the dismissal of the complaint can be sustained only if the Investment Company Act and the Maloney Act give the defendants antitrust immunity for all activities that the government might prove. Neither singly nor in combination, however, do those acts provide such sweeping immunity.[10]

2. The district court's conclusion that Section 22(d) of the Investment Company Act precludes all competition in the sale of shares of a mutual fund is contrary to the language of the Act, its legislative history, and

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[9] Although all the appellees moved to dismiss on the ground that the government's complaint failed to state a claim upon which relief can be granted, several appellees appended exhibits to their supporting memoranda and the government filed an affidavit describing certain attached documents in support of the allegations in its complaint. The district court, however, referred only to the allegations of the complaint. If the motions are treated as if for summary judgment, because of the introduction of matters outside the pleading (Fed. R. Civ. P. 12(b), (c)), the material allegations of the complaint must be taken as true, as with a motion to dismiss, and the inferences to be drawn from the underlying facts contained in the additionally submitted materials must be viewed in the light most favorable to the government. *Jenkins* v. *McKeithen*, 395 U.S. 411, 421; *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655; *United States* v. *New Wrinkle, Inc.*, 342 U.S. 371, 376.

[10] Even if some of the actions of the appellees are immunized, the determination of the precise extent of such immunity may not readily be determined at the pleading stage "because of the absence of a factual record * * *." *Scheuer* v. *Rhodes*, *supra*, slip op. 17.

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its longstanding interpretation by the agency responsible for its administration.

A. Section 22(d) establishes a limited system of vertical restraints: resale price-maintenance in the sale of open-end mutual fund shares by "dealers" to investors. Thus, Section 22(d) provides that if a class of redeemable security issued by an investment company is being currently offered to the public by or through an underwriter, "no principal underwriter of such security and *no dealer shall sell any such security* to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus * * *" (emphasis supplied).

By its terms Section 22(d) thus expressly excludes transactions between dealers from any price limitation, its requirements apply to sales of investment company securities by principal underwriters or dealers "to any person except a dealer * * *." Section 22 (d) therefore does not make lawful underwriter-dealer sales agreements designed to suppress a secondary inter-dealer market. The legal analogy is to state fair trade laws which do not validate agreements to set prices in second-hand markets.

Section 22(d) similarly does not cover the appellees' efforts to prohibit a secondary brokerage market. That section applies only to shares sold to the public by a fund, its principal underwriter or "dealers." It does not apply to transactions in outstanding shares that investors sell to other investors through a broker. Indeed, it does not even mention "broker."

As enacted in 1940, the Investment Company Act defined both "dealer" and "broker" separately.[11] Congress was quite precise in its use of both terms; they appear individually in various sections of the Act and, most importantly, together in a number of ways.[12] Thus, when Congress intended to include both brokers and dealers within a given provision, it used both terms. The use of "broker" in various sections of the Act and its omission from Section 22(d) reflects a deliberate intent to exclude brokerage transactions from the price-maintenance restrictions on sales to investors contained in that section. See, *e.g., Federal Trade Commission* v. *Sun Oil Co.,* 371 U.S. 505, 514-515; *T.I.M.E. Inc.* v. *United States*, 359 U.S. 464, 470-471.[13]

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[11] See p. 5, *supra*, n. 4.

[12] "Broker" was used without any reference to a dealer in Sections 2(a)(6), 3(c)(2), 10(b)(1), 17(e)(1) and 17(e)(2). 15 U.S.C. 80a-2(a)(6), -3(c)(2), -10(b)(1), -17(e)(1) and (2). "Dealer" was used without reference to broker in Sections 2(a)(29), 2(a)(40), 22(c) and 22(d). 15 U.S.C. 80a-2(a)(29), -2(a)(40), -22(c), -22(d). Both "broker" and "dealer" were used together in Sections 1(b)(2), 2(a)(11), 9(a)(1), 9(a)(2), 12(d)(3), and 30(a). 15 U.S.C. 80a-1(b)(2), -2(a)(11), -9(a)(1) and (2), -12(d)(3), -30(a). See 54 Stat. 789, *et seq.*

When Congress amended the Act in 1970 (84 Stat. 1413), it continued to employ the terms "broker" and "dealer" together in Sections 2(a)(19)(A)(v), 2(a)(19)(B)(v), 12(d)(1)(B) and 12(d)(1)(E)(i). 15 U.S.C. 80a-2(a)(19)(A)(v) and (B)(v), -12(d)(1)(B) and (E)(i). In addition, it also used the general term "broker-dealer" in Sections 22(b)(1) and 22(b)(2). 15 U.S.C. 80a-22(b)(1) and (2).

[13] Section 22 is entitled "Distribution, Redemption, and Repurchase of Redeemable Securities," and all of its subsections concern transactions in or from the primary distribution chain of fund-underwriter-dealer-investor. There is nothing in the section, viewed as a whole, indicating an intent to regulate investor transactions executed through a broker.

In short, Section 22(d) permits a mutual fund to fix the price at which its shares may be sold to an investor by a person acting as a "dealer," but not the price at which two investors may transfer shares through a person acting as a "broker."

B. The district court's conclusion that the legislative history indicates that Section 22(d) was intended to suppress price competition in a secondary market for mutual fund shares rested largely on statements, studies and articles appearing decades after that Section was enacted (App. A, *infra*, pp. 50–55) and which are of slight value, if any, as evidence of congressional intention in 1940.[14] The few items in the actual history of the Act to which the court referred do not support its conclusion.

Noting one brief reference in the voluminous hearings and studies preceding the Act to the so-called "bootleg" secondary market in which price competition existed (App. A, *infra*, pp. 49–50), the district court concluded that Section 22(d) was intended to eliminate that market. There is, however, not one statement in the hearings, the committee reports, or the debates to support that conclusion. The reference

[14] For example, the court relied upon characterization of the purpose and intended scope of Section 22(d) provided at Congressional hearings in 1967 in a different context which did not directly involve the question of its application to secondary markets. As a recent article demonstrates, statements of prior commentators about the history and purpose of Section 22 are not supported by close analysis of its history. See Heffernan & Jordan, *Section 22(d) of the Investment Company Act of 1940—Its Original Purpose and Present Function*, 1973 Duke L. J. 975.

to the "bootleg" market relied upon by the court consisted of one brief descriptive paragraph in a comprehensive SEC study of the investment company industry which totalled more than four thousand pages.[15] The SEC did not indicate that this market was a problem requiring congressional regulation, and the original bill[16] contained no provision comparable to the portions of Section 22(d) here involved. In the hearings there was no reference to the "bootleg" market in the discussion of Section 22(d) and its purposes.[17]

Section 22(d), as enacted, first appeared in a superseding bill reflecting a negotiated compromise between the SEC and the mutual fund industry. The elimination of the secondary market was not included in a list of the differences between the original and new bills (Senate Hearings, pt. 2, at 1118), and neither the Senate nor the House report referred to the "bootleg" market.[18] Indeed, the House Report described

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[15] SEC, *Report on the Study of Investment Trusts and Investment Companies*, H. Doc. No. 707, 75th Cong., 3d Sess.; H. Doc. No. 70, 76th Cong., 1st Sess.; H. Doc. No. 279, 76th Cong., 1st Sess., pts. 1–3; H. Doc. No. 136, 77th Cong., 1st Sess.; H. Doc. No. 246, 77th Cong., 1st Sess. The last two volumes of the report were not submitted to Congress until after the Act had been passed.

[16] S. 3580, 76th Cong., 3d Sess. The bill is set forth in the Hearings before a Subcommittee of the Senate Committee on Banking and Currency on Investment Trusts and Investment Companies, 76th Cong., 3d Sess., pt. 1, at 1–32 ("Senate Hearings").

[17] The "bootleg" market was referred to in the hearings in connection with Section 22(f), as is noted below. See p. 22, *infra*.

[18] See S. Rep. No. 1775, 76th Cong., 3d Sess. 16; H. Rep. No. 2639, 76th Cong., 3d Sess. 20. Nor was there any pertinent reference to Section 22(d) in the debates. See 86 Cong. Rec. 9807–9819, 10069–10071.

Section 22(d) as prohibiting only "investment companies from selling their redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public." H. Rep. No. 2639, *supra,* at 20.

As the House Report indicates, the overriding purpose of Section 22(d) was to prohibit sales of mutual fund shares to some persons, in the course of a primary distribution of such shares, at prices lower than those paid by the investing public. The legislative history of Section 22 reveals that, in addition to excessive sales loads, one of the principal evils which concerned Congress was the discriminatory sale of mutual fund shares, in their primary distribution, to insiders at prices below the price to the public, thereby permitting riskless trading by insiders and dilution of the value of shares held by investors.[20]

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[19] The Senate Report similarly stated that the purpose of Section 22(d) was "to prohibit the sale of redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public." S. Rep. No. 1775, *supra*, at 16. This statement, like that of the industry witness quoted by the court (App. A, *infra*, p. 38), does not purport to apply to sales in a secondary market, but rather was aimed at sales during a primary distribution of shares, to which the original SEC bill explicitly referred. Senate Hearings, pt. 1, at 15.

[20] See, *e.g.*, SEC, *Investment Trusts and Investment Companies*, pt. 2, H. Doc. No. 279, 76th Cong., 1st Sess. 809–820, 847–874; Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 10065, Investment Trusts and Investment Companies, 76th Cong., 3d Sess., at 58–59, 78, 80–81; Senate Hearings pt. 1, at 136–145, 187–188, 288–291; *id.*, pt. 2, at 332–336, 485, 514–527, 612, 660–663, 799–801, 836–863, 940–941, 949, 1053, 1057; *id.*, pt. 3, at 1085–1096; *id.*, pt. 4, at 1118; H. Rep. No. 2639, *supra*, at 8, 20; S. Rep. No. 1775, *supra*, at 6, 7, 16.

The existence of secondary markets in which price competition occurred would not weaken the congressional efforts to eliminate these problems. Contrary to the district court's conclusion, it would not result in "price discrimination between similarly situated investors" (App. A, *infra,* p. 47), because all investors would be equally free to avail themselves of the secondary market. With respect to the problem of excessive sales loads, the existence of a secondary market in which there is price competition might induce the mutual funds themselves to lower their sales loads.

C. The Commission has explicitly and repeatedly interpreted the Act from the outset as permitting competitively-priced transactions in secondary markets for mutual fund shares, notwithstanding Section 22.[21] Although such a contemporaneous construction by an agency responsible for administering a statute it helped to draft is entitled to the greatest weight

[21] Thus, by letter dated March 14, 1941, in response to a request by appellee NASD, the SEC's general counsel rendered a formal opinion that a broker-dealer would not be required by Section 22(d) to observe the current offering price in a sale to an investor when acting as a broker, although he would if acting as a dealer. The opinion was published by the SEC (11 Fed. Reg. 10992) and is still listed as an authoritative "interpretative release" in the current SEC regulations. 17 C.F.R. 271.

One month later the full Commission noted—with no suggestion that it was barred by Section 22(d)—the existence of a "secondary market" in mutual fund shares, operating "in the range between the public offering price and the redemption price * * *," which "closely resembles the traditional over-the-counter market in other securities * * *." *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38, 46, n. 12.

The Commission itself adopted the general counsel's 1941 analysis in 1946 (*Oxford Co.*, 21 S.E.C. 681), where it stated

(*Zuber* v. *Allen,* 396 U.S. 168, 192), the district court erroneously disregarded these interpretations as being merely *"ad hoc* decisions" (App. A, *infra,* p. 67, n.61). But that characterization—and many settled administrative interpretations upon which this Court has relied could be similarly characterized—cannot obscure the fact that for more than 30 years the agency has followed this interpretation.[22]

that the requirement that sales be made at public offering price "does not apply to broker transactions, as we have long ago advised the trade." *Id.* at 690.

More recently, in 1972, when a broker-dealer requested exemption from Sections 17(a)(1) and 22(d) of the Act to permit it to buy other funds' shares for its affiliated mutual fund holding company from the principal underwriters of such other funds at dealer cost rather than the public offering price, the SEC denied the request because the broker-dealer would be acting as a broker, not a dealer, and would therefore not be subject to Section 22(d). *Mutual Funds Advisory, Inc.*, Investment Co. Act Rel. No. 6932, Jan. 12, 1972.

The industry, too, apparently understood at the outset that Section 22(d) did not require that inter-dealer and brokerage transactions be at the public offering price. See, *e.g.*, Motley, *Federal Regulation of Investment Companies Since 1940*, 63 Harv. L. Rev. 1134, 1145 (1950); NASD *Manual* ¶ 5269. Indeed, the NASD acknowledged in the district court that Section 22(d) does not appear to bar all secondary market transactions at other than the public offering price—including particularly inter-dealer sales and sales by an investor to another investor through a broker (NASD Memorandum in Support of Motion to Dismiss, p. 13).

[22] As noted above (see p. 16, *supra*, n. 14), the court relied heavily on statements made by SEC representatives in 1967 in support of their efforts to have Section 22(d) repealed (App. A, *infra*, pp. 51–54). Despite the breadth of some of the language, the statements were directed at resale price maintenance in the primary distribution of mutual fund shares and did not purport to apply to the secondary markets, which, because of the restraints alleged in the complaint, have not been permitted to develop.

3. The district court further erred, we submit, in holding that Section 22(f) of the Investment Company Act immunized appellees' practices from the antitrust laws. Neither the language, purpose, or legislative history of that section supports the ruling.

Although the restrictive practices specified in the complaint involved underwriting agreements and dealer sales agreements, the court concluded that they were immunized from antitrust challenge by Section 22(f), which provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

The restraints alleged in the complaint, however, do not in terms involve restrictions imposed by mutual funds on the transferability or negotiability of their shares, and it cannot be concluded on the basis of the complaint alone that all of the restraints that the government might prove would be covered by Section 22(f), whatever its effects might be.

In any event, the district court erred in concluding that Section 22(f) was "a necessary companion" to Section 22(d), intended to implement the statutory suppression of competitive secondary markets (App. A, *infra,* p. 56). Unlike Section 22(d), Section 22(f) had a forerunner in the original SEC bill, which

would have authorized the SEC to prohibit restrictions on transferability or negotiability of mutual fund shares, Senate Hearings, pt. 1, at 16. A Commission official testified that some investment companies had included such restrictions in their certificates as a means of combatting what "they call the bootleg market," and that such restrictions take away "a big portion of the owner's right of initiative," the authority was sought to regulate such restrictions, if necessary. Senate Hearings, pt. 1, at 292–293. Such authority was provided in Section 22(f).

The legislative history, however, contains no indication that Section 22(f) itself, without any implementing Commission regulations,[23] was intended to eliminate a competitive secondary market.[24] Rather, it was intended to authorize the SEC to impose requirements which must be satisfied if restrictions on transferability or negotiability were to be valid under the Act. See S. Rep. No. 1775, *supra,* p. 16; H. Rep. No. 2639, *supra,* p. 20.[25]

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[23] The Commission has not adopted any regulations pursuant to Section 22(f).

[24] An industry counterproposal offered as a substitute for the SEC bill contained no provision for restrictions on transferability. Senate Hearings, pt. 2, at 1057. If Section 22(f) was really intended to assist, rather than restrict, the industry in its efforts to eliminate a secondary market, it is unlikely that the industry's bill would not have explicitly so indicated.

[25] Requirements imposed by the Commission would be in addition to such limitations under other federal and state laws as might be applicable to efforts to restrict the transferability or negotiability of the shares of a mutual fund. For example, the laws of Massachusetts and Maryland, where several of

Finally, even if Section 22(f) could be read as authorizing a mutual fund to impose vertical restrictive provisions upon a principal underwriter and through it upon dealers handling its shares, it would not immunize the collusive action to secure such restrictions alleged in Count I of the complaint. This Court has held that, where unilateral conduct is sanctioned by a regulatory statute, agreement among competitors to engage in that conduct may nevertheless be an antitrust violation. *Georgia* v. *Pennsylvania R.R.*, 324 U.S. 439, 456–459. As noted (*supra*, pp. 7–8), the government's complaint in this case charged such collective action by the appellees

4. Alternatively, the district court held that the appellees' practices have an "implied immunity" from the antitrust laws that results from the "pervasive" regulatory scheme of the Investment Company and the Maloney Acts (App. A, *infra*, p. 59). That conclusion, however, is erroneous.

A. Regulatory legislation does not ordinarily result in "implied" antitrust immunity for the activities of those who are subject to regulation. "Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." *United States* v. *Philadelphia*

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the appellee funds are incorporated, require that restrictions on transferability of a share appear on the face of the share certificate. Mass. Laws Ann., C. 156B, sec. 27; Md. Code Ann. Art. 23, sec. 27(c). See also 8 Del. Code, sec. 194.

Nat'l Bank, supra, 374 U.S. at 350–351.[26] This Court has repeatedly rejected claims of broad implied antitrust immunity in cases involving extensively regulated industries. See *Philadelphia Nat'l Bank, supra* (banks); *Silver* v. *New York Stock Exch., supra* (securities exchanges); *California* v. *Federal Power Commission,* 369 U.S. 482 (natural gas producers); *Otter Tail Power Co.* v. *United States,* 410 U.S. 366 (electric utilities); and *United States* v. *Radio Corp. of Am.,* 358 U.S. 334 (broadcasters).

Such antitrust immunity has been found only where the statutory scheme defines and specifies an exclusive regulatory responsibility to deal comprehensively with questions of competition. See *Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296; *Hughes Tool Co.* v. *Trans World Airlines, Inc.,* 409 U.S. 363. Under these decisions, for immunity to exist (1) the conduct challenged in the antitrust litigation must constitute the "precise ingredients" of a case subject to the agency's regulatory and remedial responsibilities (*Pan American, supra,* 371 U.S. at 305); (2) the statutory scheme must require the agency to focus particularly on competitive considerations in exercising those powers (*id.* at 308–309); and (3) the agency must have express authority under the statutory scheme to immunize the conduct in question

[26] Moreover, "since resale price maintenance is a privilege restrictive of a free economy * * *," statutes authorizing such restrictions are to be construed "strictly." *United States* v. *McKesson & Robbins, Inc., supra* 351 U.S. at 315–316.

from the antitrust laws (*id.* at 309).[27] See *Hughes Tool, supra,* 409 U.S. at 384–389.

These criteria are not met here and the district court did not even attempt to apply them. It merely stated generally that the "pervasive" regulatory scheme of the Investment Company and the Maloney Acts immunizes the defendants' activities here challenged (App. A, *infra,* p. 59). The Commission's regulatory authority, however, is carefully defined as to subject matter, scope of power, and standards to be applied.[28]

B. Similarly erroneous is the district court's interpretation of *Silver* v. *New York Stock Exchange, supra. Silver* involved the application of the antitrust laws to the New York Stock Exchange, in the exercise of its self-regulatory function by terminating direct wire connections between member and non-member firms. The SEC had no authority to review the Exchange's action. This Court held that antitrust im-

[27] These factors are reflected in this Court's opinion in *Philadelphia Nat'l Bank, supra,* 374 U.S. at 351, where *Pan American* is distinguished. Accord, *Ricci* v. *Chicago Mercantile Exch.,* 409 U.S. 289, 302–303, n.13.

[28] Thus, while Section 22(f) gives the Commission certain rule-making authority (which it has not exercised) with respect to restrictions on transferability of shares imposed by a mutual fund, as explained *supra,* p. 23, this section gives no authority over the horizontal combination of the NASD and its members charged in Count I of the complaint or the dealer-underwriter sales agreements challenged in the remaining counts. In any case, the section does not require the Commission to examine competitive considerations or empower it to grant antitrust immunity. Cf. *City of Lafayette* v. *Securities & Exchange Commission,* 454 F.2d 941 (C.A.D.C.).

munity would be implied only if the particular acts of self-regulation fell within the scope and purposes of the Securities Exchange Act, and then only to the minimum extent necessary to make the regulatory act work. *Id.* at 357. Had the Exchange's actions been subject to SEC review, the Court said, then "a different case" as to antitrust exemption would be presented. *Id.* at 358, n. 12.[29]

The district court stated that the present antitrust suit is that "different case" (App. A, *infra,* p. 62). Since NASD rules are subject to SEC review, the court reasoned, application of the antitrust laws would be neither necessary nor appropriate. This is especially so, the court concluded, since the Maloney Act (which requires the NASD to register with the SEC) requires the SEC to employ antitrust standards in reviewing NASD rules (15 U.S.C. 78*o*-3(b)(8)) and expressly confers immunity from conflicting statutes. 15 U.S.C. 78*o*-3(n).

The court's reasoning, however, ignores the horizontal conspiracy alleged by the government. The complaint challenges no rule or regulation of the NASD or the SEC. None of the NASD rules, on its face, requires or necessarily results in suppression of the secondary brokerage or inter-dealer markets.[30]

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[29] The majority opinion specifically referred to the SEC's review of NASD disciplinary action and the express antitrust exemption under the Maloney Act, but declined to decide how such a case should be treated. *Ibid.*

[30] Indeed, when the Commission approved Rule 26 of the NASD Rules of Fair Practice, governing the distribution of mutual fund shares, it expressly recognized that the rule would not affect transactions in the secondary market. *Proposed*

Rather, this case involves a broad and continuing course of conduct on the part of the NASD and its members, including purported NASD interpretations of its rules communicated to its members but not submitted to or reviewed by the Commission.[31]

This case thus closely parallels *Silver*. The NASD activities challenged in the complaint that have never been reviewed or approved by the SEC are immune from antitrust attack only if they are (1) clearly within the scope and purposes of the Investment Company or Maloney Acts, and (2) necessary to make those acts work. The former act was designed to eliminate such problems as excessive sales loads and the

Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc., supra, at 9 S.E.C. 38, 44, 46, n. 12.

[31] Documents attached to the government's opposition to the motions to dismiss indicate that the NASD approached the Commissions staff in 1959 and broached the idea of an interpretation of NASD Rule 26 which would have prevented NASD members from participating in the secondary inter-dealer market. The staff advised the NASD that neither the Investment Company Act nor its legislative history would support such a rule and that it would oppose this interpretation if the NASD formally proposed it to the Commission. The NASD thereupon stated that it would abandon the proposal, but, without prior notice to the Commission, sent a letter to all principal underwriter members urging them to include in their sales agreements with dealers, and to enforce, contractual provisions restricting inter-dealer transactions. Such immunity as might exist if the NASD had followed the procedures prescribed by the Maloney Act for obtaining Commission review of its actions would, of course, be unavailable if the NASD had ignored procedures ~~prescribed in the Act for obtaining~~ and had failed to obtain such Commission review. *United States* v. *Borden Co.*, 308 U.S. 188, 197–202; *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 225–227.

operation of funds in the interest of underwriters and dealers rather than in the interest of investors (15 U.S.C. 80a–1(b)(2) and 15 U.S.C. 80a–22(b)), while the latter act expressly proscribes NASD rule-making that fixes prices and commissions. 15 U.S.C. 78o–3(b)(8). The appellees' activities, however, have resulted in the elimination of secondary brokerage and inter-dealer markets and in the fixing of prices and commissions on all mutual fund transactions, to the disadvantage of the investing public. Consequently, they are not entitled to immunity and constitute a combination in restraint of trade in violation of the Sherman Act.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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May 1974.

APPENDIX A

United States District Court
for the District of Columbia
(Civil Action No. 2454–72)
GENEVIEVE M. HADDAD
v.
THE CROSBY CORP., ET. AL.
(Civil Action No. 338–73)
UNITED STATES OF AMERICA
v.
NATIONAL ASSOCIATION OF SECURITIES DEALERS, ET AL.
(Civil Action No. 426–73)
ARTHUR GROSS, ET AL.
v.
NATIONAL ASSOCIATION OF SECURITIES DEALERS, ET AL.
FILED DECEMBER 14, 1973.
JAMES F. DAVEY, *Clerk.*

MEMORANDUM OPINION

I

THE NATURE OF THE CASE

The above-captioned lawsuits are civil actions alleging violations of the federal antitrust laws in connection with the distribution of securities of open-end management investment companies ("mutual funds").[1]

[1] By definition an open-end management investment company is any issuer which (1) "is or holds itself out as being primarily . . . in the business of investing, reinvesting, or trading in securities" (15 U.S.C. § 80a–3); (2) is not a face-amount

The operations of such companies are governed generally by the Investment Company Act of 1940[2] (the 1940 Act).

In Civil Action No. 2454–72, plaintiff Haddad purports to sue on behalf of a class and subclass of mutual fund investors. Haddad alleges violations of the antitrust laws [Sherman Act, Sections 1–3, 15 U.S.C. §§ 1–3)] and the securities laws [Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. § 78j(b); Exchange Act Rule 10b–5, 17 C.F.R. § 240.10b–5 (1972)]. The antitrust claim is that the various defendants, including underwriters of and dealers in mutual fund shares and unnamed co-conspirators have agreed, combined and conspired to inhibit, or to refuse to participate in, transactions as agents or brokers in mutual fund shares at prices below the applicable public offering prices established in the prospectuses of such mutual funds and have placed unreasonable restraints upon the transferability of such shares. In essence, the securities claim is that there is a failure to disclose the alleged antitrust violations and that such failure constitutes an independent violation of the securities laws. Haddad alleges damages to her and her purported class of undetermined millions of dollars. Haddad's antitrust claim requests treble damages and injunctive relief. The securities claim requests actual damages, punitive damages, and injunctive relief.

Civil Action No. 338–73 is brought by the Antitrust Division of the U.S. Department of Justice. The complaint alleges violations of Section 1 of the Sherman Act, 15 U.S.C. § 1. The gist of the complaint is that

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certificate company or a unit investment trust (15 U.S.C. § 80a–4); and (3) is "offering for sale or has outstanding any redeemable security of which it is the issuer" (15 U.S.C. § 80a–5).

[2] 15 U.S.C. § 80a–1, *et seq.* (1970).

defendants National Association of Securities Dealers (NASD),[3] funds and dealers have participated in agreements, combinations, and conspiracies, the effect of which has been to inhibit a "market" for "brokerage transactions" and thereby to suppress the growth of a "secondary market in mutual fund securities," and to cause the public to pay artificial and non-competitive sales loads for mutual fund shares. The government complaint seeks only prospective injunctive relief.

Civil Action No. 426–73, the Gross case, is another private antitrust suit and purported class action which substantially duplicates the government allegations in No. 338–73. This action seeks injunctive relief and treble damages for injury to the purported plaintiff class over an indeterminate past period.[4]

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[3] The NASD, incorporated in Delaware on July 18, 1939, became registered under the Maloney Act, § 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o–3, on August 7, 1939. National Association of Securities Dealers, Inc., 5 S.E.C. 627 (1939). It is the only association ever to have applied for or been granted registration under the Maloney Act. Its membership is comprised of some 4400 broker-dealers and principal underwriters.

[4] Since the filing of the above-captioned actions, some fifty private suits, purporting to be class actions under *Fed. R. Civ. P.* 23, have been filed in various United States District Courts around the country. These cases have been transferred to this district by the Judicial Panel on Multidistrict Litigation, and are collectively cited as: In Re Mutual Fund Sales Antitrust Litigation, Civil Action No. Misc. 103–73. Pre-trial discovery and other activity in all cases (including the instant cases) has been stayed pending disposition of the motions to dismiss under consideration here.

The Court has also reserved judgment in all alleged class suits on the question of whether the actions may be maintained as class actions under *Fed R. Civ. P.* 23.

The individual defendants in each case are principal underwriters[5] or broker-dealers[6] in mutual fund shares.[7] Additionally the NASD is named as a defendant in all three cases. In each case the defendants have moved to dismiss the complaints, pursuant to *Fed. R. Civ. P.* 12(b) on the grounds:

(a) That as a matter of law, Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(d), establishes a system of fixed, retail price maintenance in the distribution of investment company securities which is totally inconsistent with antitrust concepts and which accordingly creates, as Congress clearly intended, an exemption and immunity from

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[5] A principal underwriter is defined by the 1940 Act as any underwriter who as principal purchases from (an open-end investment) company, or pursuant to contract has the right . . . from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company. 15 U.S.C. § 80a-2(a)(29).

[6] A broker is defined by the 1940 Act as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." 15 U.S.C. § 80a-2(a)(6). A dealer is defined as "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U.S.C. § 80a-2(a)(11).

[7] The identities of all the parties in each of the above-captioned cases are reflected in the accompanying Orders.

antitrust liability for the defendant dealers' conduct in maintaining the fixed, public offering price of such securities;

(b) That as a matter of law, Section 22(f) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(f), sanctions contractual restrictions on the transferability or negotiability of investment company securities, subject to supervision of the Securities and Exchange Commisson (SEC), whch restrictions are totally inconsistent with antitrust concepts and which restrictions, therefore, as incorporated in the defendant dealers' publicly-filed investment company sales agreements, are exempt and immune from antitrust liability; and

(c) That by the Investment Company Act of 1940, Congress subjected the acts and practices of the defendant dealers in the distribution of investment company securities to continuous and pervasive regulation by the SEC as well as NASD acting under the SEC's supervision; and, accordingly, the SEC has exclusive jurisdiction to regulate those acts and practices, and such acts and practices are exempt and immune from the claims herein alleged as violations of the Federal antitrust laws.

The motions were consolidated for argument.[8]

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[8] In opposition to the motions to dismiss all the plaintiffs also rely on the proposition that a complaint should not be dismissed for failure to state a claim unless it appears beyond a doubt that plaintiffs are unable to prove any set of facts which would entitle them to relief. Neither the defendants nor this Court have any argument with that general proposition, but, as the issues are drawn here for purposes of these motions to dismiss, they are strictly legal ones as to which the facts as alleged in the complaints or otherwise are not relevant.

II

THE REGULATION OF MUTUAL FUNDS

The dispute can only be determined ultimately by an analysis of the several subsections of Section 22 of the 1940 Act and an antitrust exemption purportedly given by Section 15A(n) of the Securities and Exchange Act of 1934 (the Maloney Act) [15 U.S.C. 78*o*–3(n)]. Before reaching that point, however, it would seem appropriate to view the overall regulatory scheme imposed by Congress on investment companies through the 1940 Act.

It became apparent to the Congress in 1935 that the disclosure and antifraud provisions of the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act) were not adequate for the regulation of investment companies. Accordingly, it directed the SEC to make a comprehensive study of the investment company industry with a view to proposing corrective legislation.

The SEC did so[9] producing a draft "Investment Trust Bill" which was the subject of hearings conducted by a Senate subcommittee.[10] Representatives of the investment company industry were invited to participate in the hearings. Ultimately a compromise bill emerged which finally became law as the Investment Company Act of 1940, 15 U.S.C. § 80a–1 *et seq.*[11]

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[9] *Report of the SEC, Investment Trusts and Investment Companies, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Companies, H.R. Dock. No.* 279, 76th Cong., 1st Sess. (1939) (hereinafter cited as *Investment Trust Study of 1940*).

[10] *Hearings on S. 3580 Before a Subcomm. of Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. (1940) (hereinafter cited as *1940 Senate Hearings*).

[11] That Act included § 22(d), one of the sections in controversy in this case, discussed *infra.* Section 22(d) prohibited sales

The 1940 Act brought many investment companies within the disclosure requirements of the federal securities laws for the first time. It tightened up those requirements and tailored them to prohibit certain undesirable practices in the investment company industry. Presently, pursuant to the 1940 Act investment companies must register themselves (§§ 7 and 8) and their shares [§ 24(a)] with the SEC, update periodically their filings with quarterly and annual reports [§§ 30(a)–(c)], and submit prospectuses and sales literature to the SEC [§ 24(b)]. Companies must issue to their shareholders, at least semi-annually, financial reports containing specific types of information [§ 30(d)].

The 1940 Act also imposes detailed restrictions upon investment company structure, conduct, financial policies, and dealings with and by affiliates.[12]

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of investment company shares to the public at any price other than the fixed public offering price.

[12] The Act delimits permissible methods for selecting directors of investment companies (and trustees in the case of investment trusts) (§ 16), sets out qualifications for securities custodians [§ 17(i)] and methods of safekeeping securities [§ 17(g)], and prohibits indemnification for official conduct [§§ 17 (h) and (i)]. Certain persons guilty of prior malfeasance are barred altogether from affiliating with investment companies, advisers, custodians, and principal underwriters (§ 9). Others who commit misconduct or abuse their positions of trust can be enjoined (§ 36). Misappropriation of company funds is made a federal crime (§ 37).

The Act also sets out minimum capitalization requirements for the companies (§§ 14 and 18). It requires a majority shareholder vote for changes in a company's open-end or closed-end nature, its diversification, its capacity to borrow money, issue senior securities, underwrite others' securities, purchase and sell real estate and commodities, or make loans, its investment policies, and its fundamental business (§ 13). Certain dividend distributions are barred unless timely disclosed to the shareholders (§ 19). Investment companies are barred from partici-

In 1938 (prior to the enactment of the 1940 Act), the Congress had amended the 1934 Act through the passage of the so-called "Maloney Act," 15 U.S.C. § 78o–3. The Maloney Act provided for the registration with the SEC of a national securities association with rule-making power upon the finding by the SEC that—

> the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not

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pating in certain types of securities transactions [§ 12(a)] and from making certain loans (§ 21). Some proxy solicitations are barred [§ 20(a)] and some exchanges need prior SEC approval (§ 11). Reorganization plans must be submitted to the SEC, which can render a negative advisory report and seek an injunction with respect to such reorganizations (§ 25). Voting trusts and cross or circular ownership patterns are barred (§ 35). Accountants must meet certain criteria, be selected in a particular fashion, and perform certain functions (§ 32). The regulated companies must keep and refrain from destroying certain books and records (§§ 31 and 34). Unit investment trusts (§ 26) and face amount certificate companies (§§ 28–29) are given special regulatory treatment.

The Act curtails the pyramiding of mutual funds [§§ 12(d)–(g)]. Unless it is itself the principal underwriter, no investment company may acquire shares of another company whose principal underwriter is related to the first company [§ 10(f)]. At least 40% of the company's board must consist of independent directors (§ 10). Advisory contracts must first be approved by a majority of directors unaffiliated with the adviser or by a majority of shareholders [§ 15 (c)]. Investment company transactions conducted by or with affiliated persons are prohibited in some cases and narrowly circumscribed in others (§ 17).

> designed to permit unfair discrimination between customers, or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.[13]

When Congress enacted the Maloney Act in 1938 it specifically provided:

> If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail. 15 U.S.C. § 78o–3 (n).

The defendant NASD is the only securities association registered with the SEC under the Maloney Act.

By § 22(a) of the 1940 Act, Congress gave the NASD, as a registered national securities association, the power to promulgate rules setting the minimum price at which its members may buy redeemable fund shares from a fund, the maximum price at which its members may resell to or redeem with a fund, and the minimum period which must elapse after sale before a member may resell to or redeem with a fund. The SEC can exercise its overall supervisory power to promulgate rules superseding NASD's rules on sale, redemption and repurchase prices, holding periods, and sales loads [§ 22(c) 1940 Act].

Section 22(b)(1) of the 1940 Act empowers the NASD to adopt rules prohibiting members from charging "excessive" sales loads, provided that such rules "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters."[14] In

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[13] § 15A(b)(8), 15 U.S.C. § 78o–3(b)(8).

[14] Before 1970, then-Section 22(b) authorized the NASD to issue rules barring "unconscionable" and "grossly excessive" sales loads, and then-Section 22(c) empowered the SEC to issue superseding rules for both NASD members and non-members.

so doing the NASD is expressly freed from a provision[15] in the Maloney Act which had prohibited it from issuing rules designed to impede "a free and open market," "fix minimum profits," "impose any schedule of prices," or "impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." Section 22(b)(3) of the 1940 Act, added in 1970, authorizes the SEC to alter and supplement the NASD's Section 22(b)(1) rules.[16] And in 1970, Congress added Section 22(b)(4) to the 1940 Act to the effect:

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a–22(b)(4).

An investment company, its principal underwriter, and its dealers are prohibited from selling redeemable securities for distribution to the public except at a current public offering price described in the prospectus [§ 22(d)]. Dealers and principal underwriters may, however, sell such securities to other dealers, the principal underwriter or the fund at other than a public offering price. (*Id.*)

An investment company may restrict the transferability and negotiability of its shares, but only insofar as that is done in conformity with the company's

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[15] § 15A(b)(8), 15 U.S.C. § 78o–3(b)(8).

[16] The SEC may also grant qualified exemptions from NASD rules for "smaller companies" [§ 22(b)(1)]. Section 22(b)(2), another 1970 addition, gives the SEC the same rate-fixing powers over non-NASD broker-dealers as Section 22(b)(1) gives the NASD over its members. An underwriter whose shares are distributed by non-members of NASD, however, may elect to have its shares sold under the NASD rather than the SEC sales load rule. [§ 22(b)(2)].

registration statement and not in contravention of SEC rules [§ 22(f)].[17]

By rules and regulations upon its own motion and by order upon application, the Commission may conditionally or unconditionally exempt persons, securities, or transactions, or classes thereof, from any provision in the Act or any rule or regulation thereunder, to the extent such exemption is in the public interest and not inconsistent with investor protection and the Act's purposes [§ 6(c)].[18]

Finally, no person may be held liable for any act done in conformity with an SEC rule, regulation, or order which is later invalidated [§ 38(c)].

Since 1940, the SEC has actively regulated the pricing and distribution of mutual fund shares. The Com-

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[17] The 1940 Act contains other provisions with respect to distribution. Redemption privileges may not be suspended or postponed for more than seven days after tender except during certain exceptional circumstances as defined by the SEC [§ 22(e)]. A fund may not issue shares for services or property other than cash or securities except as a dividend or shareholder distribution or in a reorganization [§ 22(g)]. Thus watering of shares is prevented.

Investment companies issuing periodic payment plan certificates may charge no more than a 9% sales load, nor deduct more than 50% of that load from the first year's payments, nor deduct disproportionate amounts, nor allow periodic payments of less than certain small amounts, nor make proceeds subject to management or other fees which exceed the amount the Commission prescribes as reasonable (§ 27). 1970 amendments added refund requirements and empowered the SEC to make rules with respect to reserves. (*Id.*)

Close-end funds are specially regulated with respect to watering and repurchase prices (§ 23).

[18] Baum v. Investors Diversified Services, 286 F. Supp. 914, 921 (N.D. Ill. 1968), *aff'd*, 409 F. 2d 872 (7th Cir. 1969).

mission has promulgated a rule [19] for calculating fund share prices. It has promulgated another rule [20] allowing discount sales to certain groups and individuals and has periodically proposed [21] and adopted [22] amendments to this rule. It recently proposed a third rule [23] relating to no-load exchange privileges for fund shareholders who wish to switch to other load funds. The Commission has entertained a wide variety of applications for exemption from these rules and the relevant statutory sections and has granted some of these applications.[24] SEC administrative proceedings have barred both underpricing and overpricing of fund shares.[25]

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[19] Rule 22c-1, 17 C.F.R. § 270.22c-1, adopted in Investment Co. Act Release No. 5519 (1969), CCH *Fed. Sec. L. Rep.* '67-'69 Decisions ¶ 77,616.

[20] Rule 22d-1, 17 C.F.R. § 270.22d-1, adopted in Investment Co. Act Release No. 2798 (1958).

[21] Investment Co. Act Release No. 5507 (1968), in CCH *Fed. Sec. L. Rep.* '67-'69 Decisions ¶ 77,609; Investment Co. Act Release No. 6069 (1970) in CCH *Fed. Sec. L. Rep.* '69-'70 Decisions ¶ 77,826 and Investment Co. Act Release No. 7571 (1972) in CCH *Fed. Sec. L. Rep.* '72-'73 Decision ¶ 79,148.

[22] Investment Co. Act Release No. 6347 (1971), in CCH *Fed. Sec. L. Rep.* '70-'71 decisions ¶ 77,953.

[23] Rule 22d-2, proposed in Investment Co. Act Release No. 7555 (1972), CCH *Fed. Sec. L. Rep.* '72-'73 Decisions ¶ 79,132.

[24] See the list of more than 100 such applications in 4 CCH *Fed. Sec. L. Rep.* at p. 68,751 *et seq.* The Commission staff has issued an abundance of letters in response to "no action" requests with respect to these rules and the basic statutory provisions. From 1971 through March 21, 1973, there were 49 such letters listed in 4 CCH *Fed. Sec. L. Rep.* at pp. 63,134; 63,789; and 63,894.

[25] *See, e.g., Spiro Sideris*, Exchange Act Release No. 8816 (1970) (underpricing); *Russell L. Irish*, Exchange Act Release No. 7687 (1965), CCH *Fed. Sec. L. Rep.* '64-'66 Decisions ¶ 77,274 (overpricing). The Commission has also sought to regulate excessive "indirect" compensation to fund dealers. *E.g.*, SEC

The SEC has approved NASD Rule 26 which regulates in great detail the distribution, redemption, and repurchase of mutual fund shares.[26] The rule[27] says, *inter alia,* that principal underwriters must require their dealers to sign selling agreements containing certain restrictive provisions, that sales loads may not be "unfair," that the public offering price must be calculated in a particular fashion, that dealers and underwriters may not withhold customers orders or accumulate inventories, that certain conditional orders are barred, that the fund may not redeem at prices above net asset value, that sales loads must be refunded if the purchasers redeem soon after purchase, that fund shares may not be purchased at prices lower than the fund's next-quoted bid, and that non-contract dealers may not sell their shares back to the fund unless they are record owners of the shares. The SEC has supervised NASD enforcement of this rule and reviewed NASD enforcement proceedings.[28]

For more than three decades, since the enactment of the 1940 Act, the agreements between dealers and principal underwriters, and between principal underwriters and mutual funds, have been filed with the SEC. The agreements are filed under both the 1933 Act and the 1940 Act.[29] The Investment Trust Study of 1940 described such agreements in de-

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approval of new NASD Rules of Fair Practice, Section 26(k), which bars members from selling certain investment companies' shares in such a way that the companies will reciprocate with portfolio brokerage commissions, and conversely, Exchange Act Release No. 10147 (May 14, 1973), 5 *Fed. Sec. L. Rep.* ¶ 79,372.

[26] *Proposed Amendment to the Rules of Fair Practice of National Ass'n of Securities Dealers, Inc.*, 9 SEC 38 (1941).

[27] NASD Rules of Fair Practice, Article III, Section 26 in CCH NASD Manual ¶ 2176.

[28] *See* note 25 *supra.*

[29] *See* Part IV *infra.*

tail.[30] The 1940 Act specifically calls for written contracts between funds and their principal underwriter [§ 15(b)]. As noted above, the Commission has approved a NASD rule which requires dealer-underwriter agreements; and Commission decisions have frequently turned on particular provisions of the dealer-underwriter agreements.[31]

III

THE OPERATION OF A MUTUAL FUND: RESALE PRICE MAINTENANCE

We look briefly at the manner in which a typical mutual fund operates within the foregoing framework.[32]

A mutual fund is an investment company which invests in the securities of other corporations and issues and has outstanding common stock representing an interest in the assets of the fund. The owner of the stock of the fund is entitled, on demand, to receive from the fund his proportionate share of the market value of the fund's net assets. To insure that the fund has sufficient cash or liquid assets on hand to meet current redemptions, the fund offers its common stock continuously. The offering price per share consists of

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[30] *See* note 47 *infra* and accompanying text.

[31] *See, e.g., Mutual Funds Advisory, Inc.*, Investment Co. Act Release No. 6932 (Jan. 12, 1972); *First Multifund of America, Inc.*, Investment Co. Act Release No. 6700 (1971), CCH *Fed. Sec. L. Rep.* '70–'71 Decisions ¶ 78,209 at p. 80,602; *Russell L. Irish*, Exchange Act Release No. 7687 (1965), CCH *Fed. Sec. L. Rep.* '64–'66 Decisions ¶ 77,274 at 82, 431 n. 13.

[32] *See generally Investment Trust Study of 1940; Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337*, 89th Cong., 2d Sess. (1966) (hereinafter cited as *Public Policy Report*).

the "net asset value" per share, computed daily, plus a sales charge or "load." The viability of a fund thus depends upon a distribution system which will effect continuous sales at prices which will support current redemption demands.

The primary distribution of the shares of a fund is controlled for the most part by § 22(d) of the 1940 Act and follows a basic pattern throughout the industry, *i.e.,* (1) a fund enters into a contract with a principal underwriter who has the exclusive right to purchase the shares from the funds; (2) the principal underwriter acts only as a wholesaler supplying shares to retail dealers; (3) the retail dealers, who sell the shares to the investing public, are bound by contracts, commonly known as uniform sales agreements, with the principal underwriter which require that those dealers shall not sell at other than the public offering price, thus insuring that the price of the fund shares will not be the subject of competition among sellers of shares in the same fund; (4) the sales charge or "load" (which usually amounts to 7.5% to 8.5% above net asset value) is split between the underwriter and the dealer making the sale while the fund receives the net asset value component of the public offering price; and (5) when the shares are redeemed by the fund, as they must be upon demand, the redemption price is the net asset value prevailing at the time of redemption.

It is obvious from the foregoing outline of marketing procedures that the sale and distribution of mutual fund shares is accomplished through a retail price maintenance system which is patently repugnant to the free and open competition requirements of the Sherman Act. This price maintenance scheme, however, does not operate in a vacuum. Rather, it is expressly immunized from the otherwise applicable anti-

trust laws by virtue of the provisions of the 1940 Act and the Maloney Act. As the SEC recently reported to Congress "Section 22(d) is an exception to the usual congressional policy, expressed in the anti-trust laws, against price fixing.[33]

It has been authoritatively recognized that the Maloney Act, superimposed upon the regulatory scheme of the 1940 Act, provides a limited immunity for participants in the primary distribution system of mutual fund shares under SEC-approved NASD rules. That exemption[34] was noted by Mr. Justice Frankfurter in his dissenting opinion in *International Association of Machinists* v. *Street,* 367 U.S. 740, 809–10 n.16 (1961):

> The Maloney Act of 1938 added § 15A to the Securities Exchange Act of 1934. 52 Stat. 1070, 15 U.S.C. § 78o–3. In order to be registered, a number of statutory standards must be met. The statute specifically requires that an association's rules provide for democratic representation of the membership and that dues be equitably allocated. See § 15A(b) (5) and (6). Only one association, the National Association of Securities Dealers, Inc., has ever applied for or been granted registration. NASD membership comprises roughly three-quarters of all brokers and dealers registered with the Securities and Exchange Commission. Loss, Securities Regulation

[33] *Public Policy Report* 218–19. *See Report of the Staff of the Securities and Exchange Commission on the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* pt. I, at 1 (November 10, 1972) [hereinafter cited as *SEC Staff Report on Repeal of* §*22*(*d*)], CCH *Fed. Sec. L. Rep.* No. 450 (Nov. 15, 1972) pt. II, at A–1.

[34] *See also* the exemption from the antitrust laws provided by § 22(b)(4):

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a–22(b)(4).

766–67 (1951, Supp. 1955). Sections 15A (i) and (n) of the Act authorize the NASD to formulate rules which stipulate that members shall refuse to deal with nonmembers with immunity from the antitrust laws. See S. Rep. No. 1455, 75th Cong., 3d Sess. 8–9 (1938); Loss, *op. cit., supra,* 769–770. The Commission has stated that it is "virtually impossible for a dealer who is not a member of the NASD to participate in a distribution of important size." *National Association of Securities Dealers, Inc.,* 19 S.E.C. 424, 441.

Again, in *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 227 n.60 (1940), Mr. Justice Douglas stated:

> It should be noted in this connection that the typical method adopted by Congress when it has lifted the ban of the Sherman Act is the scrutiny and approval of designated public representatives. Under the N.I.R.A. this could be done through the code machinery with the approval of the President as provided in §§ 3(a) and 5, *supra* note 18. Under § 407(8) of the Transportation Act of 1920, [41 Stat. 482; 49 U.S.C. § 5(8)], carriers, including certain express companies, which were consolidated pursuant to any order of the Interstate Commerce Commission were relieved from the operation of the antitrust laws. *And see the Maloney Act (§ 15A of the Securities Exchange Act of 1934; 52 Stat. 1070) providing for the formation of associations of brokers and dealers with the approval of the Securities and Exchange Commission and establishing continuous supervision by the Commission over specified activities of such associations.* * * * (Emphasis added.)

The plaintiffs recognize a limited antitrust immunity accorded to the primary distribution system. The gravamen of their complaints, however, is that the defendants have conspired to use the primary distri-

bution system to foreclose the development of a secondary market in mutual fund shares. This is allegedly accomplished through the use of the uniform sales agreements mentioned above, which even after the primary distribution of the shares, set the price at which the shares shall thereafter be sold, thus precluding the dealers from selling shares as brokers in a brokerage market or as dealers in a secondary dealer market in which marketplace conditions and arms-length bargaining would be the price-setting factors. The plaintiffs insist that Congress, while allowing the primary market to flourish with benefit of antitrust immunity, did not intend to foreclose secondary market growth, but that such secondary markets are in fact being discouraged and suppressed by certain NASD rules and the restrictive provisions contained in the industry-wide uniform sales agreements between principal underwriters and dealers.

IV

SECTION 22, 1940 ACT

The fact that a secondary market is to all intents and purposes nonexistent might seem to substantiate the plaintiffs' claims. However, the position of the plaintiffs fails to take into account that the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urgd upon Congress with no success. It is an economic fact, recognized by Congress, that the two markets—the primary market described in Part III, *supra,* and a secondary market as urged by the plaintiffs—cannot co-exist and both remain viable. Having established a resale price maintenance system in the primary distribution system in

which ordinary competitive influences cannot operate, Congress has rejected all attempts to foster a secondary market which might operate to the detriment of the primary market.

In support of those conclusions we look to the legislative history of the key sections of the 1940 Act and to the congressional intent in enacting that legislation.

A. SECTION 22(d)

Section 22(d) provides in pertinent part,

> * * * no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

As written, and as applied, that language clearly contemplates a congressionally sanctioned retail price maintenance system which is inconsistent and in conflict with the antitrust laws so far as underwriters and dealers are concerned.

Plaintiffs assert, however, that since the term "broker" or "broker-dealer" is not used in the subsection, that 22(d) permits a person to sell to another through a broker at a price less than the specified public offering price for the same shares, and that the absence of a significant brokerage market in those shares implies the existence of conspiratorial anticompetitive activity on the part of defendants to prevent the growth of that market.

This argument, however, ignores the price maintenance purpose of § 22(d) and its corollary that there must not be price discrimination between similarly situated investors.

On this latter point, so far as this Court is aware, there is no SEC or SEC staff pronouncement which can be construed to sanction price discrimination be-

tween similarly situated investors. To the contrary the SEC has said:

> The purposes of the Section [22(d)] are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus. Investment Company Release No. 2798 (December 2, 1958). *See also* Investment Company Release Nos. 8816 (February 13, 1970); 2718 (May 29, 1958); (March 13, 1940). *See In the Matter of Investors Diversified Service,* 39 SEC 680 (1960).

Again, in its most recent annual report the SEC has stated:

> Section 22(d) precludes the sale to public investors of redeemable investment company securities which are being currently offered to the public on or through an underwriter except at a current public offering price described in the prospectus. SEC, *Thirty-eighth Annual Report* 97.

Thus, the language of the statute, its legislative history and subsequent interpretation by the SEC all indicate that its object was to allow the pre-1940 method of mutual fund share distribution to continue subject to the changes necessary to suppress what was sometimes dubbed the "bootleg" market. Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940,* 37 *U. Det. L.J.* 369, 371 (1960); *In the Matter of Spiro Sideris,* Securities Exchange Act Release No. 8816 (Feb. 13, 1970).

The legislative history of § 22 indicates that in the pre-1940 period there was in fact a secondary market in mutual fund shares, a market very similar in size and scope as that for which plaintiffs here attempt

to make a case.[35] This market—the "bootleg market"—was being maintained by brokers and dealers who were not under contract with the issuers or underwriters and who were not, accordingly, a part of the established distribution system of any given fund.

Those non-contract broker-dealers, without the authority of fund underwriters and in competition with authorized retail distributors of mutual fund shares, were buying shares in the market directly from shareholders at a price slightly above the published redemption price and reselling them to investors at prices lower than those fixed by the funds' principal underwriters.[36] Contract dealers operating in the primary

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[35] *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. (1940); *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. (1940); *S. Rep. No.* 1775, 76th Cong., 3d Sess. (1940); *H.R. Rep. No.* 2639, 76th Cong., 3d Sess. (1940); *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. (1967); *Hearings on H.R. 9510 and H.R. 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess. (1967); *S. Rep. No.* 1351, 90th Cong., 2d. Sess. (1968); *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. (1969); *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. (1969); *S. Rep. No.* 184, 91st Cong., 2d Sess. (1969); *H.R. Rep. No.* 1382, 91st Cong., 2d Sess. (1970); *H.R. Rep. No.* 1631, 91st Cong., 2d Sess. (1970).

[36] *Investment Trust Study of 1940* 865; *see also Hearings on H.R. 9510 and 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess. 59 (1967) (hereinafter cited as *1967 House Hearings*).

distrisystem, on the other hand, were obligated by their distribution contracts to sell fund shares at the price (including the sales charge) set by the principal underwriters.

Thus, non-contract dealers were effectively bypassing the primary distribution system and retaining for themselves the selling commissions in full.[37] If investors bought in the secondary market but redeemed through the fund, it was feared that redemptions would exceed sales of new shares and the fund would no longer have the cash available to satisfy its redemption obligations. Thus if the proceeds of new sales did not accrue to the fund, forced liquidation might result.

The congressional response to the problems of the pre-1940 market conditions was § 22. By § 22(f), *infra*, a fund was given the right to limit transferability. By § 22(d), all dealers were required to maintain the public offering price in sales to the public. The effect of the Act was for the first time to bind non-contract dealers to the public offering price. A stated purpose of § 22(d) was to insure that "no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors."[38]

This was a clear recognition that cut-price competition resulted in discrimination between similarly situated investors.

"Another factor in the decision to give statutory sanction to price fixing in 1940 was the fact that mutual fund distribution was then and for many years thereafter conceived of as a specialized type of under-

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[37] *Investment Trust Study of 1940* 864; *Public Policy Report* 219.

[38] *1940 Senate Hearings* 1057.

writing, and underwriting was regarded as a field in which the law sanctioned price fixing." *1967 Senate Hearings* 153–54 (Chairman Cohen). *Cf. United States* v. *Morgan,* 118 F. Supp. 621, 697 (S.D.N.Y. 1953).

As alluded to *supra,* a very real danger of the "bootleg" market was that its short term price advantage would drain profits from the primary distribution system and leave the issuers unable to engage in continuous sales of new securities necessary for long-term growth and the financial health of a fund. According to one commentator, a purpose of the price maintenance provisions was "to prevent the cut-price competition which had then been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms." Greene, *Uniform Offering Price, supra,* 37 *U. Det. L. J.* at 371.

Section 22(d) has been reconsidered by Congress several times. Its modification or repeal has been urged. Congress has consistently refused to modify or repeal it, and in the course of hearings on various proposals, the position of the SEC and the congressional intent are clearly reflected. For example, in 1967 Congress was re-examining the problems of public offering prices and sales loads. It was being urged that competition for sales loads could only be realized by a repeal of 22(d). While testifying before the Senate Committee, then-Chairman of the SEC Cohen remarked:

> However, this argument [that 22(d) be repealed to allow competition] overlooks a fundamental theme of state and federal securities regulation. Securities regulation has done a good deal for the knowledgable investors, principally by increasing the quantity and improving the quality of the information available to them. But one of its primary concerns has always been the welfare of the unsophisticated

> investor, who is often the one most likely but least able to bear the burden of high charges in a competitive market. If it is desirable for millions of unsophisticated investors of modest means to invest in securities through the medium of mutual funds, it is also desirable that they should not subsequently have cause to believe that they were unfairly dealt with.
>
> On balance, we concluded therefore that a modification of the manner in which sales charges on mutual fund shares are now regulated was more consonant with the spirit and purpose of the securities laws than the elimination of Section 22(d). We therefore recommended that sales charges be limited to 5% of the amount invested, with authority in the Commission to raise this limit in appropriate situations.[39]

It is significant to note, that in the same hearings, some participants recognized that brokerage transactions, necessarily executed in the secondary market, were within the prohibition of § 22(d).

Senator Proxmire, for example, asked whether or not the SEC would recommend the repeal of 22(d) "in order to permit price competition in the sale of the same mutual fund by various broker-dealers."[40] Senator Mondale stated that section "22(d) permits—indeed makes it illegal for *agents* to sell at a sales charge less than that prescribed by the company,"[41] while Professor Paul Samuelson, Massachusetts Institute of Technology, testified that "Congress should repeal the provision in section 22(d) of the Investment Company Act of 1940 which prohibits a *broker* from selling mutual fund shares to the public at less than

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[39] *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 154–55 (1967) (hereinafter cited as *1967 Senate Hearings*).

[40] *Id.* 51–52.

[41] *Id.* 275 (emphasis added).

the public offering price." [42] Later in the hearings, Senator Mondale again remarked that "Section 22(d) makes it illegal for an *agent* to charge less than his company says he must charge as an *agent's fee*, but it does not prohibit or have anything to do with competition as between companies." [43]

Similar statements appear in the House Hearings, including the following exchange between Congressman Watkins and then-SEC Chairman Cohen: [44]

> Mr. COHEN. The statute now, and since 1940, interferes with competitive business in this area.
>
> Mr. WATKINS. Not to the extent you are proposing.
>
> Mr. COHEN. I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.
>
> Mr. WATKINS. True.

In the same House Hearings, the Department of Justice, while urging the repeal of 22(d), characterized its provisions as follows:

> It is true that Congress, in originally enacting the "fixed price" provisions of Section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws. In view of changed conditions, however, and the fact that the mutual funds are so important an outlet for the small investor, it would seem that he should not perhaps be deprived of the opportunity of purchasing his investment at a price arrived at

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[42] *Id.* 348 (emphasis added).

[43] *Id.* 769 (emphasis added).

[44] *1967 House Hearings* 711.

through the free operation of competitive forces.[45]

The SEC took the same view. The then-Chairman Cohen stated that "sellers of mutual fund securities have been insulated by Federal Law from price competition at the retail level ever since 1940" (*1967 Senate Hearings* 26), and that § 22(d) "provides an exemption from the antitrust laws" (*1967 House Hearings* 140). Furthermore, the SEC's view that § 22(d) requires retail price maintenance by broker-dealers who are members of the primary distribution system is also evident in its acceptance of NASD Rule 26(e), which provides that "no member shall offer or sell any such security except at the effective public offering price described in the current prospectus of the issuing company. . . ." CCH NASD Manual ¶ 2176.

The same thread runs through hearings conducted in 1969,[46] again with a view to the modification or repeal of § 22(d). In the 1969 Senate report, we find these comments on § 22(d):

> The provision for "reasonable loads to investors is intended to assure that the sales loads fixed by the principal underwriters (*which continue to be protected against price competition by Section 22(d) of the act*) will be established at levels which recognize the interests of investors.
>
> The provisions of this proposed section shall shall prevail over any conflicting provision of Federal law. This provision, *which is identical*

[45] *Id.* 21 (letter from Warren Christopher, Deputy Attorney General, to Chairman Harley O. Staggers, October 18, 1967).

[46] *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. (1969); *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. (1969).

> *to Section 15A(n) of the Securities Exchange Act, is designed to make it clear that no other provision of Federal law, including the antitrust laws,* prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section. *S. Rep. No.* 184, 91st Cong., 1st Sess. 18 (1969) (emphasis added).
>
> The basic sales commission charged for mutual fund shares is in most instances about 8½ percent of the total payment or 9.3 percent of the amount invested. *This charge is protected by Section 22(d) of the Investment Company Act which provides for a unique scheme of retail price maintenance. Under this section, all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime.*
>
> In its deliberations your committee considered the possibility of deleting Section 22(d) from the act. However, impressive testimony was given that there had not been sufficient study of the consequences of such an amendment. Therefore, your committee requests the Securities and Exchange Commission to review the consequences of such a proposal on both the investing public and mutual fund sales organizations and report to it as soon as is reasonably practicable. *Id.* 7–8 (emphasis added).

It is thus conclusively established that competition in the sale of a single fund's shares is effectively precluded by the 1940 Act which was intended, via § 22(d), to prevent the sale of fund shares at a price less than that fixed in the current prospectus. It is obvious that Section 22(d) of the 1940 Act was premised upon a congressional understanding that principal underwriters and broker-dealers were exempt from the antitrust laws when entering into

uniform sales agreements for mutual fund shares. It is also obvious that even at the expense of a secondary market Congress intended to maintain the resale price maintenance system. Congressional intent is entitled to substantial weight lest this Court "change the design that Congress fashioned." *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 458 (1962).

B. SECTION 22(f)

Section 22(f) is a necessary companion to § 22(d). If the problems of the competitive market created by non-contract brokers were to be met, restrictions on alienability were necessary. And Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Paraphrased, that language states clearly that if (1) restrictions on transferability or negotiability are included in the registration statement, and if (2) these restrictions are not in contravention of such rules and regulations as the commission may prescribe in the interest of the shareholders, then such restrictions are permissible even if they create departures from antitrust standards.

As noted above in the discussion of § 22(d), Congress considered the 1940 Act in the light of then-existing conditions, particularly the disruptive influence upon the market in mutual fund shares by the practices of non-contract dealers and brokers.

To overcome this disruptive competition prior to the

enactment of the 1940 Act, some funds restricted the alienability of their shares, "providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company." [47] Such restrictions were usually included in the share certificates.[48]

From and after 1940, § 22(f) required that any restriction on alienability be included in the registration statements and, additionally, that they be subject to the rulemaking authority of the SEC. Clearly, by § 22(f) Congress specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rulemaking authority of the SEC. Just as clearly Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications.

Restrictions on alienability have consistently appeared in registration statements and in uniform sales agreements since the passage of the 1940 Act. Not only are such contracts required by SEC-approved Rule 26 of the NASD Rules of Fair Practice, CCH NASD Manual ¶ 2176, but they are also disclosed in the registration statements. It is undisputed that these agreements have remained virtually unchanged since they were first filed with the SEC along with and as part of the registration statements. It is also undisputed that the SEC has never challenged the validity of uniform sales agreements. Indeed, the SEC has noted that these agreements require a dealer "to place all orders with the principal underwriter and

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[47] *Investment Trust Study of 1940* 865.

[48] *1940 Senate Hearings* 292 (remarks of SEC General Counsel David Schenker).

to refrain from any attempt to obtain shares from other sources." [49]

It is thus apparent that Congress designed §§ 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is "incompatible with the maintenance of (an) antitrust action." *Silver v. New York Stock Exchange*, 373 U.S. 341, 358 (1963).

Whether the mutual fund marketing structure mandated by Congress in 1940 should be eliminated or modified is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide. In fact, in urging its complaint upon the Court, one of the plaintiffs, *viz.*, the Department of Justice, seeks to accomplish indirectly what it has failed, so far, to achieve directly—the repeal or modification of § 22(d)—in hearings before both Congress [50] and the SEC.[51]

V

IMPLIED IMMUNITY

Even if a specific exemption granted by the Maloney Act were deemed to be inadequate to grant immunity

[49] *SEC Staff Report on Repeal of § 22(d)* A-109. *See Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No.* 95, 88th Cong., 1st Sess. 98 (1963), wherein reference is made to the "fair trade arrangements established by the Act, the NASD rules and private sales agreements . . ."; Greene, *Uniform Offering Price, supra*, 37 *U. Det. L.J.* at 371-72.

[50] *1967 House Hearings.*

[51] *In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940*, SEC File No. 4-164 (1973).

from the impact of the antitrust laws, the defendants urge that the 1940 Act, particularly § 22 thereof, created a pervasive regulatory scheme which highlighted the Congressional intent to immunize the investment company industry from the impact of the antitrust laws.

The plaintiffs, on the other hand, urge that repeals of the antitrust laws by implication are "strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." They argue that, in the instant case, plain repugnancy is not apparent.

The most recent pronouncement of the Supreme Court on this particular point is to be found in *Hughes Tool Company v. Trans World Airlines,* 409 U.S. 363 (1973).

In *Hughes Tool* the respondent TWA challenged as violative of the antitrust laws certain transactions and activities of petitioner Hughes Tool (Hughes). The Supreme Court, dismissing the action, held that the challenged transactions "were under the control and surveillance of the Civil Aeronautics Board" (CAB); that pursuant to the Federal Aviation Act of 1968 the CAB applying antitrust standards has reviewed the same kind of conduct which TWA alleged to be violative of the antitrust laws. The Court stated:

> In this context, the authority of the Board to grant the power to "control" and to investigate and alter the manner in which that "control" is exercised leads us to conclude that this phase of CAB jurisdiction * * * pre-empts the antitrust field. 409 U.S. at 385 (footnote omitted).

And the Court further stated that where—

> the CAB authorizes control of an air carrier to be acquired by another person or corporation and where the CAB specifically authorizes as in

> the public interest specific transactions between the parent and the subsidiary, the way in which that control is exercised in those precise situations is under the surveillance of CAB, not in the hands of those who can invoke the sanctions of the antitrust laws. 409 U.S. at 387.

Further the Court said that its holding was "consistent with the view expressed in *Silver v. New York Stock Exchange* . . . that a statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances *by implication* grant immunity from an antitrust claim." 409 U.S. at 385 n.14 (emphasis added).

The Court in *Hughes Tool* relied heavily on its prior decision in *Pan American World Airways v. United States,* 371 U.S. 296 (1963), which also involved the pervasive regulatory scheme of the CAB and an implied repeal of the antitrust laws. In *Pan American* the Court found that the Sherman Act could not be applied to matters which the CAB had approved in exercising its statutory function.

> It would be strange, indeed, if a division of territories or an allocation of routes which met the requirements of "public interests" as defined in § 2 were held to be antitrust violations. * * * If the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide. 371 U.S. at 309–10.

The Court then found that the implementation of antitrust policy in the public interest was for the CAB, under the Federal Aviation Act's comprehensive regulatory scheme, and not for the courts. In the case at bar, as in *Hughes Tool* and *Pan American,* there exists a pervasive regulatory scheme coupled with a legislative history manifesting congressional intent to immunize the investment company industry from the

operation of the antitrust laws to the limited extent necessary to carry out the purpose of the independently defined federal policy legislated in the regulatory act, *i.e.*, the Investment Company and Maloney Acts.[52]

The decisions in *Hughes Tool* and *Pan American* are consistent with the views expressed in *Silver* v. *New York Stock Exchange, supra,* where the Supreme Court held that the Stock Exchange was not exempt from the antitrust laws when, pursuant to its rules, it ordered its members to remove certain telephone connections they had with the offices of a non-member. Although the Exchange was generally regulated by the Securities Exchange Act of 1934, the Court noted that the SEC lacked jurisdiction to review cases such as petitioner's where the Exchange has enforced its rules. *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 358.

The Court's opinion in *Silver* turned on the fact

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[52] In Hecht v. Pro-Football, Inc., 144 U.S. App. D.C. 56, 444 F.2d 931 (1971), *cert. denied*, 404 U.S. 1047 (1972), the Court held the following to be relevant criteria for determining which conduct is immune from the antitrust laws:

"Putting the problem in this light, relevant criteria would include the specific language of the congressional statute involved, any legislative history which would throw light on the congressional intent, the relative importance of the governmental action which is asserted to override antitrust policy, whether the governmental agency is required to take into consideration the possible anticompetitive effect of its actions, whether the agency is required to adhere to a clearly defined and restricted statutory directive, and to what extent the agency's actions are subject to judicial review. 144 U.S. App. D.C. at 60, 444 F.2d at 935.

See also Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264, 270 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971), where the Court also discussed immunity criteria; United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953).

that there was no justification for the Exchange rule under the Securities Exchange Act because that rule did not provide any procedural safeguards for the petitioner. The Court did find, however, that "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." 373 U.S. at 361. The Court noted further that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, *supra.*" 373 U.S. at 360. The Court's reference, "note 12," refers expressly to the SEC's jurisdiction under the Maloney Act and states that were there such SEC jurisdiction in a *Silver*-type situation, "a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity . . ." 373 U.S. at 358 n.12.[53]

This Court is persuaded that the instant case is that "different case."[54] The Investment Company Act and the Maloney Act read together demonstrate that Congress intended to eliminate free competition in the distribution of mutual fund shares. The language of

[53] *But see* Harwell v. Growth Programs, Inc., 451 F.2d 240 (5th Cir. 1971), *reh. denied*, 459 F.2d 461, *cert. denied*, 409 U.S. 876 (1972), where the Court applied the *Silver* rationale to self-regulatory activities of the NASD. *Harwell*, however, did not involve a claim of limited antitrust immunity under § 22 of the 1940 Act.

[54] *Cf.* Gordon v. New York Stock Exchange, Inc., *et al.*, Civil No. 71-1496 (S.D.N.Y., filed Dec. 4, 1973), where the Court, in dismissing an antitrust attack on the commission structure of both the New York and American Stock Exchanges, found that the fixing of commissions falls within the congressional policy of exchange self-regulation embodied in the Securities Exchange Act of 1934.

both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency.[55] The SEC and the NASD have the statutory authority to control the area and both have in fact taken an active role. The NASD, under the control and supervision of the SEC, has adopted specific rules to govern the activities of principal underwriters and broker-dealers. The Maloney Act, Section 15A(b)(8), specifically requires the SEC to employ antitrust standards, *i.e.,* "to protect the public interest," when reviewing the rules promulgated by the NASD.[56] Still further, the SEC has adopted rules specifically designed to govern *non*-NASD members in the distribution and redemption of mutual fund shares. *See* 15 U.S.C. §§ 78o(b)(8)–(10). In connection with its regulatory function, the SEC has extensively reviewed the distribution and redemption practices in the in-

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[55] In Baum v. Investors Diversified Services, Inc., 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd on other grounds*, 409 F.2d 872 (7th Cir. 1969), the plaintiff alleged a violation of the Robinson-Patman Act. After reviewing the SEC involvement, the court held:

> The foregoing demonstrates that the SEC has exercised its broad regulatory authority in this industry to establish a framework of pricing practices within which investment companies must operate. It has specifically approved the alleged discriminatory pricing system under attack in the case at hand, and has justified the system as being "in the public interest and consistent with the protection of investors and purposes fairly intended by the policy and provisions of this Title." 286 F. Supp. at 924.

[56] *See also* Section 6(c) of the 1940 Act which empowers the SEC to "exempt any person, security, or transaction . . . from any provision" of the Act "if and to the extent that such exemption is necessary or appropriate in the *public interest* and

vestment company securities industry and even has reviewed the secondary market for such securities.[57]

This Court's opinion is further strengthened by the Supreme Court's decision last Term in *United States v. Cartwright*, 411 U.S. 546 (1973). That case challenged a regulation issued by the Secretary of the Treasury covering valuation of mutual fund shares for Federal Estate Tax purposes. The Court at least impliedly recognized the pervasive regulatory scheme in the investment company industry.

> Private trading in mutual fund shares is virtually non-existent. Thus at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund at the "asked" price, which includes the load. But shareholders "sell" their shares back to the fund at the *statutorily* defined redemption or bid price. 411 U.S. at 549 (emphasis added).

The Court went on to state that the regulation in question was "manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operates without regard for the market in mutual fund shares that the Act *created and regulates.*" 411 U.S. at 557 (emphasis added).

The plaintiffs place great reliance on other recent Supreme Court decisions. Principally they rely upon *Otter Tail Power Co.* v. *United States,* 410 U.S. 366

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consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. 15 U.S.C. § 80a–6(c) (emphasis added).

[57] *See, e.g., Public Policy Report; SEC Staff Report on Repeal of § 22(d); In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940*, SEC File No. 4–164 (1973).

(1973), in which the Court refused to imply immunity from the antitrust laws. Plaintiffs cite *Otter Tail* to show that even extensive regulation of an industry does not thereby immunize that industry from the antitrust laws. The Court's language is clear and unequivocal, however, for it found congressional intent *not* to displace the antitrust laws, but rather to retain the applicability in order to promote competition. That is not the case here.

> It is clear, then, that *Congress rejected a pervasive regulatory scheme for controlling the interstate distribution of power in favor of voluntary commercial relationships. When these relationships are governed in the first instance by business judgment and regulatory coercion,* courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws. *See United States* v. *Radio Corporation of America, supra,* at 351. This is particularly true in this instance because Congress, in passing the Public Utility Holding Company Act, . . . was concerned with "restraint of free and independent competition" among public utility holding companies. See 15 U.S.C. § 79a(b)(2). 410 U.S. at 374 (emphasis added).

Otter Tail accordingly is not controlling.

Nor does *Federal Maritime Commission v. Seatrain Lines, Inc.,* 411 U.S. 726 (1973) support plaintiffs' position. That case dealt with the scope of an express repealer of the antitrust laws in the 1916 Shipping Act[58] which by its terms, limited antitrust immunity to conference agreements approved by the Federal Maritime Commission (FMC). At issue was

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[58] 46 U.S.C. § 814. See Note, *The Shipping Industry Seeks a Safe Haven: Merger Jurisdiction for the FMC?*, 5 *Law & Pol. Int'l Bus.* 274 (1973).

whether an agreement which confers no ongoing obligations is an "agreement" within the meaning of the Act. The Court held that Congress did not intend to invest the FMC with the power to shield from antitrust liability mergers which create no continuing responsibilities. Furthermore, the Court found in examining the legislative history there was an overriding federal policy to promote competition. Since the FMC's power to immunize agreements from the antitrust laws was limited only to those agreements approved by it, this Court fails to see in what manner the claim for limited immunity in the present case offends the *Seatrain* principle since there is no similar requirement conditioning exemptions in the 1940 Act.[59]

This Court is not, of course, unmindful of the fact that "(r)epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." *United States v. Philadelphia National Bank,* 374 U.S. 321, 350–51 (1963) (footnotes omitted). *See also United States v. McKesson & Robbins, Inc.,* 351 U.S. 305, 316 (1956); *California v. FPC,* 369 U.S. 482 (1962); *United States v. Borden Co.,* 308 U.S. 188 (1939). That principle, of course, rests upon the sound

[59] *Cf.* Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 302–03 n.13 (1973), where the Court recognized that where a regulatory act contains an express exemption from the operation of the antitrust laws, or where a regulatory agency is specifically directed to consider competitive factors in the exercise of its duties, it is necessary to conclude that Congress intended to exempt from the antitrust laws activity subject to the administrative agency's adjudicative or rule-making authority.

Moreover, the cases at bar do not involve the doctrine of primary jurisdiction. *See, e.g.,* Chicago Mercantile Exchange v. Deaktor, 42 U.S.L.W. 3330 (U.S. Dec. 3, 1973) (No. 241); Ricci v. Chicago Mercantile Exchange, *supra.*

basis that "antitrust laws represent a fundamental national economic policy." *Carnation Co. v. Pacific Westbound Conference,* 283 U.S. 213, 218 (1966).[60] With that fundamental policy in mind, the Court does not hold that the Investment Company Act and the Maloney "completely displace the antitrust laws." *Hughes Tool, supra,* 409 U.S. at 389. What the Court does find is a "limited antitrust exemption." *Carnation Co., supra,* 383 U.S. at 219. Here, given the fact that Congress clearly intended to substitute a pervasive regulatory scheme, *i.e.,* § 22 of the 1940 Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is clear that the price maintenance practices complained of are immune from ordinary antitrust strictures.[61]

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[60] *See, e.g.,* United States v. Borden Co., 308 U.S. 188, 200 (1939). *Cf.* Maryland & Virginia Milk Producers Ass'n Inc. v. United States, 362 U.S. 458 (1960).

[61] Notwithstanding this conclusion, two SEC rulings, cited by plaintiffs in support of their contention that the price maintenance requirements of § 22(d) would not apply if the broker-dealer acted in the capacity of a broker rather than a dealer, deserve mention. One is an Opinion of SEC General Counsel, Investment Company Act Release No. 87 (March 14, 1941). In response to an abstract inquiry, the General Counsel thought that the term "dealer" in § 22(d) "refers to the capacity in which a broker-dealer is acting in a particular transaction." He concluded that when a broker-dealer acts as a broker in a specific transaction, he is not bound to sell at the public offering price. In the Matter of Oxford Co., Inc., 21 SEC 681 (1946), involved a disciplinary proceeding for a broker-dealer alleged to have violated his fiduciary duty to his clients. There the broker-dealer sold mutual fund shares from one of his accounts to another related account, charging the public offering price and retaining the sales load for himself. The SEC, citing the General Counsel's opinion, rejected the technical defense that the subject's actions were mandated by § 22(d).

The Court concludes that reliance on these two decisions is misplaced. They are *ad hoc* decisions in no way related to the

VI

CONCLUSION

In light of the foregoing, the Court concludes that the plaintiffs in each of the above-captioned cases have failed to state a claim upon which relief can be granted, and that accordingly the motions to dismiss in each such case must be granted. Orders are filed herewith.

H. F. CORCORAN,
Judge.

Dated: DECEMBER 14, 1973.

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regulated distribution system. Furthermore, they do not address the problem of likely discrimination between similarly situated investors. Such shortcomings preclude a basis for allowing industry-wide cut-price competition in brokerage transactions contrary to the purposes of § 22(d).

APPENDIX B

United States District Court
for the District of Columbia

(Civil Action No. 338–73)

UNITED STATES OF AMERICA, PLAINTIFF

v.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC., FIDELITY FUND, INC., WELLINGTON FUND, INC., THE CROSBY CORPORATION, VANCE, SANDERS & COMPANY, INC., THE WELLINGTON MANAGEMENT COMPANY, INC., MERRILL LYNCH, PIERCE FENNER & SMITH, INC., BACHE & COMPANY, INC., REYNOLDS SECURITIES CORPORATION, E. I. DUPONT, GLORE FORGAN, INC., E. F. HUTTON, INC., WALSTON & COMPANY, INC., DEAN WITTER & COMPANY, INC., PAINE, WEBBER, JACKSON & CURTIS, INC., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., DEFENDANTS

Filed DECEMBER 14, 1973.

JAMES F. DAVEY,
Clerk.

ORDER

This matter having come on for ruling on the defendants' motions pursuant to Rule 12 of the Federal Rules of Civil Procedure to dismiss the complaint for failure to state a claim upon which relief can be granted, the parties having filed briefs in support of their respective positions, and the Court being fully advised in the premises and having issued its Memorandum Opinion on December 14th, 1973;

It is this 14th day of December, 1973,

Ordered That the above-captioned case be, and the same is, hereby dismissed on the merits and with prejudice for failure to state a claim upon which relief can be granted.

H. F. CORCORAN,
Judge.

APPENDIX C

United States District Court,
District of Columbia

(Civil Action No. 338-73)

UNITED STATES OF AMERICA, PLAINTIFF

v.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL., DEFENDANTS

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN That the United States of America, plaintiff herein, appeals to the Supreme Court of the United States from the judgment for defendants entered December 14, 1973.

This appeal is taken under the Expediting Act, 15 U.S.C., Sec. 29.

Dated at Washington, D.C. FEBRUARY 11, 1974.

DANIEL R. HUNTER,
Attorney for Plaintiff.

U.S. GOVERNMENT PRINTING OFFICE: 1974

No. 73-1701

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

UNITED STATES OF AMERICA, *Appellant*

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL., *Appellee*

On Appeal From the United States District Court For the District of Columbia

MOTION TO AFFIRM OF APPELLEE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

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CITATIONS

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On Appeal From the United States District Court For the District of Columbia

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MOTION TO AFFIRM OF APPELLEE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Appellee National Association of Securities moves, pursuant to Rules 16(1)(c) and 16(1)(d) of the Rules of this Court, that the judgment of the District Court be summarily affirmed. The decision below is so plainly

correct and the issues raised by appellant are so insubstantial as not to require plenary review. The opinion and order of the District Court are set forth in Appendices A and B, respectively, to the Jurisdictional Statement.[1]

STATEMENT

This is an appeal from a judgment dismissing a complaint which alleged violations of the Sherman Act in connection with the distribution of securities of open-end investment companies or mutual funds as they are commonly called. The National Association of Securities Dealers, Inc. ("the NASD") was named as a defendant in one count of the complaint.

1. The NASD is a creature of Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3. Section 15A, the so-called Maloney Act of 1938, supplements the regulation of the over-the-counter securities markets by the Securities and Exchange Commission ("the Commission"). Section 15A provides a system of cooperative regulation of the over-the-counter markets through voluntary associations of brokers and dealers. The NASD, which is the only such association, currently has approximately 3300 members of whom about half are primarily engaged in the sale of mutual fund securities. The NASD is subject to a reticulated pattern of statutory regulation, including comprehensive review and supervision by the Commission. As more fully pointed out below, the rules of the NASD, for example, must satisfy prescribed statutory standards which, *inter alia,* deal with anti-competitive prac-

[1] The time for filing a motion to affirm the appeal was extended to and including July 15, 1974.

tices, and provision is made for antitrust immunity. Section 15A thus embodies an accommodation of the policies of securities laws and those of the antitrust laws.

In addition to its general, over-the-counter, regulatory responsibilities under the Maloney Act, with the enactment of the Investment Company Act ("the Act") in 1940, 15 U.S.C. 80a-1 *et seq.*, the NASD was vested with authority over the pricing of shares of mutual funds.

2. A mutual fund is essentially a managed portfolio of securities. It is characterized by the fact that it issues a redeemable common stock under an obligation to pay the holder his proportionate share of the market value of the fund's net assets.[2] In effect, this redemption right provides a ready "market" for a selling shareholder. Because of the redeemability feature, mutual funds generally make a continuous offering or a primary distribution of their common stock in order to prevent their assets from shrinking. The offering price per share, which is described in the fund's prospectus, consists of the net asset value per share, which is computed at least once a day, plus a sales charge or sales load in the case of the type of funds here under consideration. This public offering price is sustained by a retail price maintenance provision in Section 22(d) of the Act, as discussed below.

The method of primary distribution of these shares, both before and since the passage of the Act, has been basically as follows: The mutual fund grants the ex-

[2] Sections 2(a)(32), 5(a)(1) and 22(e) of the Act, 15 U.S.C. 80a-2(a)(32), 5(a)(1) and 22(e).

clusive right to purchase shares from the fund to a principal underwriter, who generally acts only as a wholesaler, and leaves the retailing to dealers, who enter into an agreement with the underwriter. The principal underwriter and the retail dealer divide the sales load component included in the public offering price, and the mutual fund receives the net asset value.

In addition, as discussed below, a secondary over-the-counter, inter-dealer market, in which issued and outstanding mutual fund shares are traded, has existed both before and after the passage of the Act. This has never been a brokerage market.

STATUTE INVOLVED

Section 22 of the Investment Company Act, 15 U.S.C. 80a-22, is set out in its entirety in the Appendix hereto.

THE POSITION OF APPELLANT

The NASD is named only in Count I of the complaint. That count alleges that the NASD and its members have maintained a combination and conspiracy in violation of Section 1 of the Sherman Act, 15 U.S.C. 1.

1. In naming the NASD, appellant labored under basic misconceptions about the Maloney Act, the NASD itself, its rules and its activities. Following the NASD's explanation of these matters below, appellant made a hasty retreat, and repudiated the keystone of its complaint against the NASD.

Appellant still finds itself in the same anomalous posture. Thus, as appellant states (Jur. St. 7), the complaint alleges that "to effectuate the conspiracy", the NASD "establish[ed] and maintain[ed] rules which had the effect of inhibiting the development of the sec-

ondary dealer and brokerage markets." But, then, in a total disavowal, appellant states (Jur. St. 26): "The complaint challenges no rule or regulations of the NASD . . ." Moreover, it even concedes that no NASD rule has the effect alleged in the complaint!

Appellant's same misconceptions permeate as well the relief it seeks (Compl. Prayer, ¶¶ 6 and 7). Its request that the NASD be enjoined from establishing and maintaining rules is predicated on the thesis it has now abandoned. Moreover, this prayer was obviously fashioned without regard to the detailed rule making standards, including procedures and Commission oversight, embodied in a web of provisions in the Maloney Act and the Investment Company Act, over which the Commission has exclusive jurisdiction, as discussed below. Without regard as well to the regulatory plan of the Investment Company Act for pricing, the complaint would also enjoin the NASD from fixing the price in a mutual fund transaction, which the NASD has not in any event done. The complaint would even require the NASD to include in its manual to members references as to brokerage transactions that appellant now acknowledges are already there (Jur. St. 20, n. 21).

In essence, by virtue of appellant's own acknowledgements, its misconception saturated complaint is but an apparition.

2. But whatever the allegations in this regard, appellant's underlying approach is premised on a lack of appreciation of the scope, impact and purpose of the pricing provisions of the Investment Company Act. This is particularly evident, for example, in the fact that it blinds itself, in its purported analysis of the statute (Jur. St. 16-19), from the amendments enacted

in 1970 to the Investment Company Act and their background.

The effects of the alleged conspiracy and combination about which appellant complains are that "sales of mutual fund shares have been confined to a primary distribution system and the growth and development of a secondary dealer market and a brokerage market . . . has been inhibited", and that "the public has been deprived of the benefits of free and open competition" of such markets. (Compl. ¶ 18)

As has been indicated, the price of a mutual fund share is made up of its net asset value and the sales charge or sales load. Since the issuer is obligated to redeem outstanding shares at their net asset value, shares will not be sold by their holders for less than that value. Consequently, any competition would be directed to the amount of the sales load.

The essence of appellant's complaint is that the effects of the present system of selling mutual fund shares, in the language of the court below, is "to cause the public to pay artificial and non-competitive sales loads for mutual fund shares." (Jur. St. App. 31) However, the question of sales charges was a focal point of the amendments enacted in 1970 to the Investment Company Act. These amendments, after 30 years, reaffirmed the unique system of retail price maintenance embodied in Section 22(d) of the Act, and by themselves cut the underpinnings to appellant's approach. In essence, the Congress rejected the conventional, competitive over-the-counter market concept, and refused to throw open to competition the amount of the sales load and, in turn, the price of mutual fund shares.

As will be discussed more fully below, the 1970 amendments were preceded by a Commission report to the Congress that included legislative recommendations as to sale loads. The Congress at great length reviewed this matter, including the absence of a conventional market for mutual fund shares. It considered three alternatives to treat with sales loads, which the Commission had concluded should be lowered. First, as was urged by the Commission, prescribing a maximum sales load in the statute. This was rejected.

Second, the repeal of Section 22(d). This would have permitted the sales load to be determined through competition in a conventional over-the-counter market. Its advocates included the appellant, which recognized that Section 22(d) "prescribes a unique scheme of retail price maintenance for the sales charges levied in distributing mutual fund shares to the public", and urged "that price competition in sales commissions can be allowed with advantage to investors."[3]

Repeal, however, was rejected because, *inter alia,* of a Congressional concern with the adverse effects of a competitive secondary market on the primary distribution system and on the funds themselves. The Congress unequivocally expressed its intention that the sales load fixed by the principal underwriter should be protected from competition both in the primary distribution and in the secondary market for already issued and outstanding shares.

In this connection it should be noted that appellant does make two passing footnote references to the 1970

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[3] The 1969 House Hearings, p. 135, note 38, *infra;* repeated almost identically at p. 136.

amendments in order to criticize reliance thereon by the court below (Jur. St. 16, n. 14, and 20, n. 22). Apart from its incorrect statement that the Commission urged repeal of Section 22(d), appellant, as it does repeatedly elsewhere, fallaciously treats the primary distribution and the secondary market in issued and outstanding shares compartmentally. It fails to perceive the intimate interrelationship of the two in terms of the operation and impact of Section 22(d). Thus, the then chairman of the Commission observed during the House Hearings (p. 713, note 36, *infra*):

> "They [the mutual fund industry] felt that the lifting of section 22(d) would be disastrous for the funds and those who sell them. They said that the dealers who wanted to sell mutual funds would stop buying them from principal underwriters and purchase them at cut prices in the market, and that mutual fund sales charges would thereby be driven down to a point where most dealers would stop selling them at all. In other words, they said the force of competition would reduce the charge.
>
> "They said that as a consequence the existing system of distribution would break down, the underwriters would be unable to make enough sales to offset redemptions, and the funds would be thrown into a net redemption status, and ultimately wither away."

The third approach, which the Congress adopted, was to leave the regulation of sales load as it was, under the aegis of the NASD and Commission, but to prescribe new statutory standards for sales loads in place of the then existing standard, which was found wanting.[4] Im-

[4] Under the 1970 amendments, the NASD has authority to prescribe commissions for mutual fund shares as noted below.

plementation of the amendment is in process, the NASD having made certain proposals. In addition, an exemption from the antitrust laws was specifically impressed into the Investment Company Act. At the same time, the Commission was instructed to make a study of the consequences of price competition if Section 22(d) were repealed. That study has been completed. The Commission held hearings on the matter, at which appellant appeared. The Commission is now formulating its proposals.

In this context, appellant nevertheless decided that it should resort to the antitrust court as the forum for attempting to achieve the policy it had unsuccessfully advocated to Congress in connection with the 1970 amendments, and what it was then urging the Commission to recommend to the Congress or to pursue administratively.

Appellant's utilization of the judicial process should be contrasted with the position it communicated in 1969 to the House Committee (note 38, *infra* pp. 135, 136), which at the time had not yet reported out a bill. Appellant called attention to the fact that the Senate Committee report had stated that the committee lacked adequate information on the consequences of the repeal of Section 22(d) and had requested a report on the subject from the Commission, and that the Senate Committee had made a proposal (which was later enacted) to permit associations of securities dealers to deal with the problem of excessive sales loads. Appellant then stated: "These steps are not inappropriate as interim measures."

PLENARY REVIEW IS NOT NECESSARY

In the setting as just described, it is respectfully submitted that there is no need for the plenary review being sought by appellant. The matter should be left, as the District Court correctly concluded after rejecting appellant's statutory analysis, for resolution under the Investment Company Act in accordance with the program and procedures that the Congress adopted. As the chairman of the Commission recently observed:

> ". . . The question is not resolved with respect to price competition in the distribution of mutual fund shares.
>
> "You are aware of the fact that the Antitrust Division of the Department of Justice has challenged the present practice of most funds in this regard on antitrust grounds, and the Solicitor General, it was recently reported, has agreed to prosecute an appeal of an adverse decision of the United States District Court in *United States* v. *NASD. We did not think the Antitrust Division should have proceeded on this ground under the antitrust laws, because we think the problem should be resolved as a regulatory matter under the Investment Company Act.* They have not seen fit to comport with our general views, and we may, in the end, have a definitive court determination that will bind all of us, whatver we might otherwise have done.
>
> "In the meantime, our staff is still analyzing the information and arguments provided at the hearings on mutual fund distribution and trying to fashion a proposal. I understand that the staff's proposal is likely to be some middle ground between retention of all of the present practices intact, on the one hand, and the virtual repeal of Section 22(d) on the other. Without expressing any views of my own, I think this is an interesting

area to explore and we look forward to receiving the staff's proposals shortly." (Emphasis added.)[6]

Additionally, since the statutory provisions here at issue are admittedly unique, there is not presented a matter affecting the overall administration of the antitrust laws.

ARGUMENT

1. The Role of the NASD and the Allegations

In naming the NASD, appellant, as has been indicated, suffered from basic misconceptions. Thus, for example, the complaint (¶ 17) alleges that to effectuate the alleged combination and conspiracy the NASD

> "(a) established and maintained rules which inhibited the development of a secondary dealer market and a brokerage market in mutual fund shares;
>
> "(b) established and maintained rules which induced broker/dealers to enter into sales agreements with principal underwriters, with knowledge that sales agreements contained restrictive provisions which inhibited the development of a secondary dealer market and brokerage market in mutual fund shares;"

In the court below, in its memorandum and reply in support of its motion to dismiss, the NASD pointed out: (1) that under the Maloney Act, the forum for any attack on NASD rules was not the courts but rather the Commission, which had exclusive jurisdic-

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[6] Address by Ray Garrett, Jr., entitled "Mutual Funds: Fifty Years and Beyond", May 15, 1974.

tion of the matter, (2) that like all its rules, the one NASD rule—Section 26 of the NASD Rules of Fair Practice—dealing with the distribution of mutual fund shares, had been specifically cleared by the Commission under statutory provisions that contain antitrust standards, and (3) that the NASD rules enjoyed antitrust immunity. Furthermore, the NASD reviewed in detail the aforementioned Section 26, which made it clear that there was no warrant for appellant's allegations.

Confronted with these considerations, at the oral argument, appellant repudiated the foregoing allegations. It announced, as it later confirmed by letter to the court, that the complaint was not attacking any NASD rules. This also is appellant's current position and dilemma. Indeed, appellant acknowledges that none of the NASD rules requires or necessarily results in suppression of the secondary brokerage or inter-dealer markets. (Jur. St. 26)

In this connection it may be noted that following oral argument, the court below invited the Commission to participate in the case. The Commission advised the court by letter[6] that it would likely participate if appellant was attacking the NASD rules, but as already indicated appellant had abandoned its attack. In its letter (pp. 2-3) the Commission summarized the Maloney Act as follows:

> "The Maloney Act was enacted to encourage the formation of self-regulatory organizations; . . . Congress contemplated that the Securities and Exchange Commission would 'exercise appro-

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[6] Letter of August 9, 1973, from Lawrence E. Nerheim, the Commission's general counsel.

priate supervision in the public interest' over the activities of these self-regulatory organizations and further granted to the Commission 'supplementary powers of direct regulation.' Accordingly, in order for an association of over-the-counter broker-dealers to be registered under the Maloney Act, the Commission has to find that the association's rules meet a number of standards specified in Section 15A(b), including that they are *designed 'to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers* . . .,' Section 15A(b)(8). In the same manner, for a registered association to amend its rules, the Commission must find, under Section 15A(j), that the amendment is consistent with the standards of Section 15A(b). And Section 15A (k)(1) of the Act authorizes the Commission, 'after appropriate notice and opportunity for hearing,' to abrogate rules of a registered association, 'if such abrogation is necessary or appropriate to assure fair dealing by the members of such association . . . [or] to protect investors or effectuate the purposes of this title.[3]' Among the purposes of the title are the *competitive considerations* contained in Section 15A(b)(8). Finally, Section 15A(n) of the Maloney Act provides that:

'If any provision of [the Maloney Act] . . . is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provisions of this section shall prevail.' " (Emphasis added.)

"[3] The Commission's authority under 15A(k)(1) extends to partial abrogation of a rule of a registered association insofar as the rule has been interpreted or applied by the association in a manner inconsistent with the purposes of the Maloney Act. *See* Securities and Exchange Commission, Securities Exchange Act Release No. 9632 (June 7, 1972)."

The letter (p. 4, n. 5) refers to Section 15A(n) as an "express antitrust exemption." See *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 227, n. 60; *International Association of Machinists* v. *Street,* 367 U.S. 740, 809-10, n. 16 (dissenting opinion).

The letter (p. 3), in continuing its description of the statute, stated:

> "The Maloney Act thus vests in the Securities and Exchange Commission broad regulatory authority over the rules of registered over-the-counter broker-dealer associations like the NASD, and provides for precise standards and procedures to be employed by the Commission in authorizing or reviewing those rules."[7]

Confronted with the fact that the keystone of its attack on the NASD has been pulverized, appellant relies on what it characterizes as "purported NASD interpretations of its rules communicated to its members but not submitted to or reviewed by the Commission." (Jur. St. 27). To support this sweeping charge, with its ring of multiplicity and frequency, appellant has been compelled to reach back 15 years to cull out an isolated item from the reams of material that had been submitted to it by the NASD. The incident, narrated as if it involved the clandestine intrigue of a cabal, is described in ambiguities which conceal what actually transpired (Jur. St. 27, n. 31).

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[7] The letter (p. 4) also pointed out that if this litigation does "in fact constitute attacks on matters which are within the Commission's supervisory jurisdiction over NASD rules then the teaching of *Ricci* [v. *Chicago Mercantile Exchange,* 409 U.S. 289, 302-303, n. 13] and the very structure of the Maloney Act require you to conclude that these cases cannot be maintained under the antitrust laws." This observation is equally applicable to NASD rules under the Investment Company Act.

The vintage incident, a letter of June 22, 1959, has, as a result of lack of any remaining postulate of wrong, become the strand on which appellant hangs its case against the NASD.[8] Despite its irrelevancy, the letter merits some elaboration in view of appellant's overtones of impropriety which also spring from misconception.

At the outset it should be emphasized (1) that this letter to NASD members dealt with the primary distribution of shares emanating from the issuer and not the secondary market in previously issued and outstanding shares, and (2) that the letter did not in any way affect the price paid by the investor. It dealt with non-contract dealers participating in a primary distribution. Under any reading of Section 22(d), as appellant recognizes, such non-contract dealers must sell to an investor at the public offering price.

The letter was openly and widely distributed and described as well in the NASD monthly newsletter to its members.[9] It dealt with the situation of dealers with selling group agreements who took down shares from the underwriter to fill orders—at a discount from the public offering price—from other dealers who were not parties to the selling group agreement. As indicated in the letter, this practice permitted a non-contract dealer to evade the requirement of Section 26(c) of the NASD Rules of Fair Practice that dealers in the primary distribution have a selling group agreement with the underwriter, which the Commission had

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[8] The letter (GX-18) was one of 30 exhibits included in an affidavit filed below by appellant. The NASD offered no evidence.

[9] Such material is routinely sent to the Commission. See Rule 15Aj-1(d) adopted by the Commission under the Maloney Act, 17 C.F.R. 240.15Aj-1(d).

cleared.[10] While this requirement affected non-contract dealers, so does the section's provision relating to redemptions. It was cleared by the Commission over the objections of such dealers that the provision "creates unfair discrimination."[11] Pointing out that mutual fund shares are "a peculiar type of security", the Commission observed:

> "The nature of these shares and the manner in which they are distributed and redeemed are so extraordinary as perhaps to justify extraordinary treatment."[12]

Promulgation of the letter was done neither in stealth nor in violation of any procedures, as appellant suggests.[13] The letter had the following genesis: The NASD committee handling the matter had proposed an interpretation of Section 26(f)(2) of the NASD Rules of Fair Practice which would have prohibited contract dealers from taking down investment

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[10] In passing upon Section 26, which deals with the primary distribution and redemption of mutual fund shares, the Commission pointed out that Section 26(c) "in effect requires . . . [a selling] agreement by providing that a member of the Association who is a principal underwriter may not sell to another member at a concession from the public offering price unless a sales agreement is in effect between the parties". *National Association of Securities Dealers, Inc.*, 9 SEC 38, 44 (1941).

[11] *Ibid.* p. 44.

[12] *Ibid.* p. 45.

[13] As another of its misconceptions, appellant urged below that the letter required approval of the NASD membership. Having been advised below by the NASD that this was not required in view of *National Association of Securities Dealers, Inc.*, 17 S.E.C. 459, 465 (1944), appellant here has refrained from this specific contention, but not the overtones of procedural deficiency, of which there were none.

company shares from underwriters except to fill orders from members of the public (GX-16 and 17, see note 8, *supra*).[14] The matter was discussed informally by NASD representatives with the Commission staff on March 11, 1959. According to the latter's memorandum of conference (GX-6), the staff objected to the proposed step, which the memorandum stated was to take the form of a proposed interpretation of Section 1 of Article III of the NASD Rules of Fair Practice. That section provides that a "member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." The memorandum of conference, while stating that the Commission staff advised that "the statute"

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[14] The June 22, 1959 letter suggested amendment of selling group agreements to the effect—and it should be added as they ordinarily do—that shares (other than for bona fide investment by the dealer) may be taken down at a discount only to fill orders in hand from members of the public. Section 26(f)(2) of the NASD Rules of Fair Practice prohibits a member (other than a dealer buying for his own investment) from purchasing shares from the issuer or underwriter except "for the purpose of covering purchase orders already received." While Section 26(f)(2) does not specifically state that the orders must be received from members of the public, such must have been the intent in light of its purpose. Section 26(f) "is designed to eliminate any extra undisclosed profits by dealers and underwriters at the expense of the issuers and/or investors", as the NASD explained at the Commission hearing on the rule before it became effective. Public Conference on a Proposed Amendment to the Rules of Fair Practice of the National Association of Securities Dealers, Inc., March 28, 1941, pp. 9-10. If Section 26(f) were not construed as referring to orders received from the public, non-contract dealers who purchased through the contract dealer could "inventory" the shares and derive profits at the expense of the existing security holders, which Section 26(f) was intended to deny.

The letter further pointed out that strict enforcement of selling group agreements will also serve to remedy the situation.

did not prevent a contract dealer from taking down shares from an underwriter for a non-contract dealer, also states that the staff advised "that selling group agreements could and often did bar such transactions, [and] that it was hardly the function of the NASD to enforce selling group contract provisions (the PSI case was referred to)."

What evidently concerned the Commission staff was the use of NASD disciplinary procedures to enforce selling group agreements.[15] But even before the meeting with the Commission staff, the NASD Board of Governors had advised the NASD committee which was handling the matter that the Board "does not want to be in a position of enforcing selling group agreements." (GX-16)

The letter of June 22, 1959 was accordingly wholly consistent with the advice received from the Commission staff.[16] It was warranted as well by the NASD

[15] The "statute" referred to in the Commission staff memorandum of conference is not identified, but when read together with the reference to the PSI case, the "statute" would seem to be the Maloney Act. The PSI case referred to was *National Association of Securities Dealers, Inc.*, 19 S.E.C. 424 (1945). In that case a majority of the Commission held that, in view of Section 15A(b)(8), NASD members who breached the price maintenance provisions in a conventional underwriting agreement were not subject to NASD disciplinary action for a violation of above mentioned Section 1 of Article III of the NASD Rules of Fair Practice. The Commission's conclusion was not predicated on impropriety of the price maintenance provision, but rather on its view that the Maloney Act did not contemplate "a new form of compulsion", i.e., NASD sanctions, to achieve compliance with the contractual provision involved. 19 S.E.C. at 443.

[16] The NASD summary of the Commission staff conference (GX-16) states in part: "The [Commission] staff also said that it felt that investment company underwriters should amend their selling group agreements to cover the point involved, if they so desire, and enforce the contracts themselves."

rules, as has been indicated.[17] There was no reason to keep the matter secret from the Commission; nor was it.[18]

In the face of this record—with a complaint, conceived in obvious misunderstanding, that appellant repudiates in its essentials, and which it seeks to resuscitate by reference to an irrelevant, vintage incident that was wholly warranted—appellant unabashedly closes its Jurisdictional Statement (p. 28) with a flourish and, using the broad brush, asserts that "appellees' activities", which, of course, includes the

[17] In this connection it may further be noted that an NASD letter (GX-22) included in appellant's affidavit below, which relates to the filling of orders by a non-contract dealer, analyses the matter as above stated, and then concludes that if the non-contract dealer "is not willing to arrange for a selling agreement . . . the most practical course . . . is to obtain the shares in the open market from . . . whoever makes the best market in such shares . . ."

[18] Appellant mentions (Jur. St. 8), but never elaborates on the reference in the complaint to suppression of market quotations. It is well advised, for it would suffer more of the frustration it has already experienced in attempting to mold an antitrust action on matters within the exclusive jurisdiction of the Commission. There is a network of statutory regulation to assure the integrity of quotations. Under Section 15A(b)(12), 15 U.S.C. 78o-3(b)(12), the NASD is required, as it has, to adopt rules "designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations." See, e.g., NASD Rules of Fair Practice, Art. III, Sections 5 and 6. These rules are subject to the Commission clearance and oversight under the Maloney Act as discussed earlier. In addition, the Commission itself is specifically authorized to regulate the matter of quotations under Section 15(c)(2) of the Securities Exchange Act, 15 U.S.C. 78o(c)(2). This is in addition to the general anti-fraud provisions of the Securities Exchange Act, which arm the Commission with direct regulatory authority, that would reach "suppressed" quotations, as would Section 1, Article III of the NASD Rules of Fair Practice previously referred to.

NASD, "have resulted in the elimination of secondary brokerage and inter-dealer markets and in the fixing of prices and commissions on all mutual fund transactions . . ."

Competition is the theme of the complaint, but this is not the thesis of Section 22, to which we now turn.

II. Section 22 of the Investment Company Act

Section 22 of the Act, 15 U.S.C. 80a-22, which is set out in the Appendix, deals with the sale and redemption of mutual fund shares. It embodies a unique regulatory pattern that encompasses the price at which mutual fund shares are to be sold both on a primary distribution and thereafter. The statute deals specifically with each of the two components that make up the price of a mutual fund share, i.e., net asset value and sales load.

1. Section 22(a) has remained unchanged since the Act was passed in 1940. In substance, it authorizes the NASD to adopt rules to protect existing shareholders from a dilution of their equity or other unfairness so that the "minimum price" at which shares may be purchased from a mutual fund (and also the "maximum price" which it may pay on redemption) is in "relation to the current net asset value" of the security.

Section 22(b) by its terms deals with the sales load on a primary distribution, but its impact carries over to the secondary market in issued and outstanding shares, as discussed below. Prior to the 1970 amendments, Section 22(b) in substance authorized the NASD to adopt rules so that the offering price would "not include an unconscionably or grossly excessive sales load." The 1970 amendments, which are fully

explored below, continued the NASD rule making authority but the standard was changed so that the offering price "shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors."[19]

NASD rules become effective only after they have been passed upon by the Commission in terms of compliance with Section 22 and also the applicable standards of the Maloney Act, as has been indicated. In addition, the Commission exercises continuing oversight with respect to the NASD rules, and it may adopt rules superseding or supplementing NASD rules.[20] Thus, in effect, the Commission has exclusive jurisdiction of the matter.[21]

The 1970 amendments also added Section 22(b)(4) to the statute which, in terms identical with Section 15A(n) of the Maloney Act, provides for antitrust immunity.[22]

Section 22(d) of the Act provides for retail price maintenance. The pertinent provision of Section 22(d), which has remained unchanged since the passage of the statute in 1940, provides:

> "No registered investment company shall sell any redeemable security issued by it to any person

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[19] The amended Section 22(b) relieves such rules from compliance with Section 15A(b)(8) of the Maloney Act to permit rules prescribing methods for computing, and limitations on, sales loads.

[20] Section 22(b)(3) and 22(c) of the Investment Company Act.

[21] Section 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78y(a), provides for review of Commission orders by the Circuit Courts of Appeal.

[22] Senate and House Reports, note 39, *infra*, at pp. 18 and 30, respectively.

> except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus."

Section 22(d) is of general application. It draws no distinction between newly issued shares in a primary distribution and transactions in the secondary market in already outstanding shares. Nor are its proscriptions limited to those who have selling group agreements. As long as a mutual fund is offering shares—and this is the common situation—Section 22(d) applies. It should also be noted that while Section 22(b), which as pointed out above deals with the sales load, is cast in terms of the primary distribution, it is the load permitted under Section 22(b) together with the per share net asset value which determine the public offering price that must be maintained under Section 22(d), even in the secondary market.

It should be emphasized that notwithstanding possible contrary intimations by appellant (Jur. St. 2, 15 n. 13, 16-18), it acknowledges that the retail price maintenance provisions of Section 22(d) apply to noncontract dealer transactions in the secondary market for already issued and outstanding shares. Speaking of those markets and the non-contract dealer, appellant states (Jur. St. 11, n. 8):

> "This market does not produce any monetary advantage to a 'buying' investor, since all dealer

sales to investors, under Section 22(d), must be made at the fixed public offering price so long as the same class of share is being offered to the public by the fund or its underwriter."

2. The objectives of Section 22(d) have been explained by the Commission time and again in the following terms, with which appellant disagrees:

> ". . . the purposes of Section 22(d) as stated by the Commission 'are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a public price less than that fixed in the prospectus.' [citing Investment Company Act Release No. 2798 (December 2, 1958)] . . . Section 22(d) seeks to prevent the adverse effect upon investors generally which would result from discriminatory pricing and disorderly distribution."[23]

Prior to the passage of the Act, the so-called "bootleg market" provided over-the-counter price competition in outstanding mutual fund shares. This competition existed between contract dealers, who had distribution agreements with the principal underwriters and were obligated to sell fund shares at sales loads fixed by the principal underwriter, and dealers who did not have such an agreement and obtained shares from sources other than the principal underwriter, reselling them at whatever price they chose. This caused dealers to cancel their contracts with principal underwriters. As described in the Commission study that led to the passage of the statute initially, these non-contract

> "dealers would often offer a little more than the published redemption price and ask a little less

[23] *Spiro Sideris,* Securities Exchange Act Release No. 8816 (February 13, 1970).

> than the published sale price . . . Such operations actually had the effect of initiating a small scale price war between retailers and tended to disrupt the established offering price."[24]

The response to this competitive situation was Section 22(d) which came about in the following circumstances: The original bill recommended by the Commission did not contain this provision. Extensive Senate hearings were held on that bill,[25] and the industry, while not opposing legislation, did not agree with the Commission's proposals. A spokesman for the industry suggested the framework of an acceptable bill.[26] With respect to Section 22, he stated that it

> ". . . should also provide that no securities issued by an ivestment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors."[27]

This proposal, almost in verbatim language, was again set forth in a memorandum agreement between the Commission and the industry.[28] This agreement produced a compromise bill[29] that included Section 22(d)

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[24] Investment Trusts and Investment Companies, Report of Securities and Exchange Commission ("the Commission Investment Trust Study"), Part 3, p. 865; see also Part 2, p. 241, n. 100.

[25] Hearings before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, 76th Cong., 3d Sess. on S. 3580 (1940).

[26] *Ibid.*, p. 1053.

[27] *Ibid.*, p. 1057.

[28] Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce, H. Rep. 76th Cong., 3d Sess., on H.R. 10065, p. 99.

[29] *Ibid.*, p. 96.

and was enacted. The Senate Committee Report on that bill states:

> "In addition, provision is made to prohibit the sale of redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public." Sen. Rep. No. 1775, 76th Cong., 3d Sess., p. 16.

Notwithstanding the evident breadth of the foregoing statements, appellant urges (Jur. St. 18, n. 19) that they "do not purport to apply to sales in a secondary market". But, nevertheless appellant acknowledges, see p. 22, *supra,* that Section 22(d)—the purpose and intent of which reflects these statements—embraces transactions in the secondary market in already issued and outstanding shares by both contract and non-contract dealers.[30]

The Commission's Investment Trust Study (Part 3, p. 865) pointed out that certain mutual funds attempted to overcome the price competition of the "bootleg market" by restricting the negotiability of their shares and providing that they could only be sold or tendered for redemption to the mutual fund. Section 22(f) of the Act permits restrictions on transferability and alienability, subject to certain disclosures

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[30] Appellant highlights (Jur. St. 18) a statement in the House Committee Report. The statement, as a full summary of Section 22(d), is incomplete on its face, as appellant must recognize in light of its acknowledgement that Section 22(d) embraces transactions in the secondary market in issued and outstanding shares. The statement (H. Rep. No. 2639, 76th Cong., 3d Sess., p. 20) is: "Subsection (d) prohibits [to make its argument appellant is compelled to present the statement as if the word "only" appeared at this point] investment companies from selling their redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public."

and Commission rule making authority, which has not been exercised.

In addition to the references in the 1940 legislative materials to the "bootleg market" as the framework of Section 22(d), such references abound in the wholly relevant legislative history of the 1970 amendments discussed below.

It should be added that the "bootleg market" was an "inside" inter-dealer market and not a brokerage market.[31] An indispensible ingredient of the over-the-counter markets are the so-called "market makers" who serve as conduits and make the over-the-counter markets viable. They buy and sell as principal for their own account and maintain inventories in the particular securities in which they make a market. When a customer expresses an interest in buying or selling a security to the securities firm with which he deals, that firm, whether it is acting as a broker or dealer, will ordinarily look to the market maker to obtain or dispose of the customer's securities as the case may be. On its face, Section 22(d) reaches such investor purchases.[32]

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[31] The Commission Investment Trust Study, Part 2, p. 241, n. 100 and p. 327.

[32] In view of the emphasis placed by appellant on the terms "broker" and "dealer" (Jur. St. 15), it is interesting to note that the Commission's Investment Trust Study (Part 3, pp. 857-859) in discussing trading practices, used the term "dealer" in a generic sense, and the capacity in which the dealer was acting was delineated by references to "the dealer acting as principal" and to "the dealer acting as agent." This is reflected as well in the Senate Report on the 1970 amendments (note 39, *infra,* at p. 8), which speaks of the "dealer [that] acts as principal." The dealer in a primary distribution, as previously pointed out, can take down

Similarly, the secondary market for mutual fund shares since the passage of the Act has been an inter-dealer market. As is pointed out in a recent Commission staff study referred to by appellant, "the inter-dealer firms do not deal directly with the public." [33]

The secondary market since 1940 has diminished. But this, of course, was the intended purpose of Section 22(d). But, as the recent Commission staff study pointed out, the diminution has also resulted from other independent factors. [34]

3. In 1966 the Commission submitted a report to the Congress in which it recommended statutory amendments in light of the developments that had taken place since the passage of the Investment Company Act in 1940. Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth (1966) ("the 1966

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shares only for orders he has already received, and he is designated as a "dealer" for the purpose of insulating the issuer and underwriter from liabilities for his acts. Except to the extent that it "inventories" mutual fund shares, a securities firm, whether it acts as a "dealer" or as a "broker", performs the same market function and bears essentially the same risk.

[33] See note 45, *infra.*, Part II, p. 293.

[34] These included, for example, the disappearance of the redemption fee that mutual funds at one time charged and a lessening of the percentage of the sales load retained by the principal underwriter, which have both had the effect of reducing the spread between the redemption value of shares, and the price charged to retail dealers, thereby in turn reducing the non-contract dealer's incentive to seek out selling shareholders rather than purchase shares from the underwriter on a primary distribution. See note 45, *infra.*, Part 2, pp. 290-294.

Commission Report")[35]. The Commission's recommendations were embodied in bills introduced in the 90th Congress. In 1967, hearings were held before the committees of both the Senate and the House of Representatives.[36] The Senate Committee reported out a bill[37], which was passed by the Senate. The House Committee took no further action.

In the 91st Congress, bills were again introduced, and further committee hearings were held on both sides of the Congress.[38] This time bills were reported out by both committees,[39] and following a conference[40], the amendments were enacted in 1970, Public Law 91-547. It may be noted that both the House and Senate bills (as was true also of the Senate Bill passed in the prior Congress) subjected sales loads to regulation by the NASD and the Commission, as embodied in

[35] Printed as H. Rep. No. 2639, 89th Cong., 2d Sess.

[36] Hearings before the Committee on Banking and Currency, U.S. Senate, 90th Cong., 1st Sess., on S. 1659; Hearings before the Subcommittee on Commerce and Finance of the Committee of Interstate and Foreign Commerce, House of Representatives, 90th Cong., 1st Sess., on H.R. 9510, H.R. 9511. Referred to as "1967 Senate Hearings" and "1967 House Hearings", respectively.

[37] S. Rep. No. 1351, 90th Cong., 2d Sess.

[38] Hearings before the Committee on Banking and Currency, U.S. Senate, 91st Cong., 1st Sess., on S. 34 and S. 296 (1969); Hearings before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, 91st Cong., 1st Sess., on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737. Referred to as "the 1969 Senate Hearings" and "the 1969 House Hearings", respectively.

[39] S. Rep. No. 91-184; H. Rep. No. 91-1382. Referred to as "the Senate Report" and "the House Report", respectively.

[40] H. Rep. No. 91-1631.

Section 22(b); their differences related to matters not here relevant.[41]

The 1966 Commission Report to the Congress called attention (p. 42) to the fact that there was only a small trading market for mutual fund shares. The report reviewed at great length (pp. 201 ff.) the entire subject of the distribution of mutual fund shares, and particularly the sales load. While the Commission was of the view that existing sales loads should be lowered (pp. 221, 222), it indicated (p. 218) an inability to act under the then existing statutory standard proscribing "unconscionable or grossly excessive" sales loads.

Then the report (pp. 218 ff.) dealt at length with retail price maintenance. Section 22(d) was referred to as one of the "statutory controls with respect to sales loads". It was pointed out that Section 22(d) "effectively prevents any price competition among dealers", and requires them to "adhere rigidly to the offering price whether the shares they sell are newly issued or already outstanding" (p. 218). Next, the background of Section 22(d) was explained (p. 219) in terms of the "bootleg market" and its consequences, basically as set forth herein earlier. It was then emphasized that Section 22(d) is unique and is "an exception to the general rule that in the over-the-counter markets charges for executing transactions are subject to negotiation" (p. 219).

The report then addressed itself to possible methods of achieving the lower sales loads that the Commission sought. The report considered the elimination of Section 22(d), pointing out (p. 222) that the advantage of such a step would be that it "would allow the proper

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[41] *Ibid.*, p. 28.

level of sales loads to be determined by the freely active forces of retail price competition." The Commission rejected this approach because it could result in price discrimination in favor of knowledgeable investors (p. 222).[42]

The Commission then advocated establishing maximum loads, and recommended in essence that "[s]ales charges for mutual fund shares may not exceed 5 percent of their net asset value at the time of sale." In this connection the Commission observed (p. 223):

> "Moreover, the mutual fund industry has operated for over a quarter of a century under the anti-competitive protection against price competition afforded by section 22(d). A maximum sales load would avoid any unsettling and unforseeable effects which abolition of retail price maintenance might have on the broker-dealer community . . ."

At the outset of the 1967 Senate Hearings (note 36, *supra*) the Committee Chairman observed (p. 1) that the Commission's report "correctly emphasized the serious problems" that had arisen since 1940, "especially in the area of mutual fund sales commissions . . ." The chairman of the Commission referred to sales charges as a "major" problem that had "received the greatest attention" (pp. 5, 25, see also p. 126). His presentation essentially repeated the observations and recommendations in the 1966 Commission Report previously summarized. He pointed out (at pp. 25-26), for example:

> "mutual fund sales charges are not determined by the normal interplay of free market forces,"
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> * * *

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[42] The Commission also thought elimination of Section 22(d) might at least temporarily favor captive organizations, which are not involved here, that are the sole distributors of the fund shares they sell (p. 222).

"It [Section 22(d)] permits the fund's principal underwriters to fix sales charges and then requires the Federal Government to enforce adherence to those prices by every retail dealer whether or not he has a contract with the underwriter and whether or not he is engaged in the initial distribution of the fund's shares."

* * *

"Sellers of mutual fund securities have been insulated by Federal law from price competition at the retail level since 1940."

This was elaborated upon in a written statement he presented (pp. 142-155), with references to Section 22(d) and the pre-1940 "bootleg market" (pp. 151, 153), and a repetition of the reasons set forth in the 1966 Commission report for its not advocating competition, but a prescribed maximum sales load (p. 154).

The Commission made a similar presentation at the 1967 House Committee Hearings, e.g., pp. 48-61, 94, 109-114, 142-143.

There were those that urged the repeal of Section 22(d). For example, in 1967 appellant, as it did again more forcefully in 1969 (see p. 7, *supra*), urged that the small investor "should not perhaps be deprived of the opportunity of purchasing his investment at a price arrived at through the free operation of competitive forces." 1967 House Hearings, p. 21.

Similarly, Professor Paul A. Samuelson urged repeal of Section 22(d) so that "there would spring up a secondary market for . . . mutual funds." 1967 Senate Hearings, pp. 348, 356, 366; see also 1969 Senate Hearings pp. 55, 58, 64.

The views expressed to both the Senate and House Committees by Professor Henry C. Wallich are of particular moment for they bring into focus the issue in

this case. Referring to the consequences of the repeal of Section 22(d), which he favored, he observed:

> "It is claimed that a 'bootleg', i.e., free market would then arise in which investors wishing to redeem could sell their shares at slightly more than the current market value which the fund itself offers. The shares would then be resold for less than what the fund would charge (including sales load). Such a market which would be perfectly legitimate, would obviously be beneficial both to investors who redeem and who purchase. The fund would lose the sales load on the shares turning over in the market instead of being reissued by it . . . the availability of shares in the market would drive down the sales load . . ." (1967 House Hearings, p. 586; to the same effect, 1967 Senate Hearings p. 1064.)[43]

A proposal to repeal Section 22(d) was embodied in a bill introduced in 1969 by Senator McIntyre, one of the members of the Senate Committee. S. 296, 91st Cong., 1st Sess., § 12(a). Senator McIntyre stated that his bill "would permit commission levels to be established by the free interplay of competitive forces in the open market." 1969 Senate Hearings, p. 5.[44]

In response to questioning by Sen. McIntyre, a Commission spokesman stated:

> "We are told that widcatting and price cutting will be ruinous to the industry. It might well be.

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[43] Repeal of Section 22(d) was also proposed by others. 1967 Senate Hearings, pp. 667-670, 731, 1018.

[44] A committee staff report summarized this provision in Senator McIntyre's bill as follows: "Repeals sec. 22(d) of the Investment Company Act. Sec. 22(d) allows mutual fund distributors and underwriters to fix sales commissions at a set price and makes it a Federal crime for any broker-dealer to sell these shares at a lower price. Repeal of Section 22(d) would allow the competitive forces of the market place to determine mutual sales commissions." 1969 Senate Hearings, p. 4.

We don't know the answers to those questions and to those possible results. It is because of that area of darkness that we just didn't feel we had enough economic background and strength to come up here and recommend a repeal of this section." (1969 Senate Hearings, pp 18-19)

This too was the position taken by the Commission in its presentation on sales loads during the 1969 House Hearings, pp. 183, 864, 901.

Instead of sales charges being determined by competition, the Congress, as the Senate Committee pointed out,

"... decided to rely on the existing self-regulatory machinery of the securities industry in order to protect public investors against unreasonable sales charges subject to appropriate Securities and Exchange Commission oversight." Senate Report, p. 7.

This was reiterated in the House Report (pp. 4-5).

The Senate Report (pp. 7-8), and also the House Report (p. 3) in practically verbatim language, stated:

"The basic sales commission charged for mutual fund shares . . . is protected by Section 22(d) of the Investment Company Act which provides for a unique scheme of retail price maintenance. Under this section, all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime."

The Senate Report in this connection pointed out (p. 8) that shares of "particular mutual funds are not sold on a 'bid and asked basis' as are other securties offered and sold in the competitive over-the-counter market."

The two committee reports further pointed out that under the amendment " . . . sales loads fixed by the principal underwriters . . . continue to be protected against price competition by section 22(d) of the Act . . ." Senate Report, p. 18; House Report, p. 30.

Yet the premise of appellant's complaint is that sales charges are not determined by competition.

The Senate Committee in its report stated (p. 8) that it had considered repealing Section 22(d), but that there was impressive testimony that there had not been sufficient study of the consequences of repeal. The committee requested the Commission to prepare a report on the subject. The Commission staff prepared such a report.[45] Thereafter, the Commission held public hearings on the subject.[46] Appellant appeared to advocate repeal.[47] As the Commission's chairman pointed out in the speech referred to earlier, the Commission is in the process of formulating recommendations. Meanwhile, to implement the provisions of the amended Section 22(b), the NASD, after extensive economic studies, has informally proposed rules which have been submitted to the Commission for its consideration.[48]

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[45] Report of the Staff of the Securities and Exchange Commission on the Potential Economic Impact of a Repeal of Section 22 (d) of the Investment Company Act of 1940 (November 1972).

[46] In the Matter of Mutual Fund Distribution and the Potential Impact of the Repeal of Section 22(d) of the Investment Company Act of 1940, File No. 4-164.

[47] *Ibid.*, pp. 2019 ff.

[48] Investment Company Act Release No. 7475 (November 3, 1970), pp. 2-3.

In view of the foregoing, we submit that appellant's approach in attacking the NASD is simply an unwarranted assault on the pattern of regulation established by the Congress.

CONCLUSION

The motion to affirm should be granted.

Respectfully submitted,

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July 1974

APPENDIX

Distribution, Redemption, and Repurchase of Redeemable Securities.

Sec. 22. (a) A securities association registered under section 15A of the Securities Exchange Act of 1934 may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or surrendering for redemption any such redeemable securities in contravention of said rules.

(b)(1) Such a securities association may also, by rules adopted and in effect in accordance with said section 15A, and notwithstanding the provisions of subsection (b)(8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its

members from purchasing, in connection with a primary distribution of redeemable securities which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operating costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(2) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 15(b)(10) of the Securities Exchange Act of 1934 as are appropriate to effectuate the purpose of this subsection with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 15(b)(8) of that Act: *Provided,* That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(3) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970 (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule repsecting excessive sales loads), the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 15A(k)(2) of the Securities Exchange Act of 1934.

(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on the date this subsection takes effect, the provisions of this subsection shall prevail.

(c) The Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any securities association, to the same extent, covering the same subject matter, and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members. Any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal under-

writer, or the issuer, except at a current public offering price described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 including any offer made pursuant to section 11(b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except—

(1) for any period (A) during which the New York Stock Exchange is closed other than customary weekend and holiday closings or (B) during which trading on the New York Stock Exchange is restricted;

(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection. Any company which,

as of March 15, 1940, was required by provision of its charter, certificate of incorporation, articles of association, or trust indenture, or of a by-law or regulation duly adopted thereunder, to postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this title, or upon the repeal or amendment of such provision, or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

(g) No registered open-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or distribution to its security holders or in connection with a reorganization.

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TABLE OF AUTHORITIES

CASES:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1701

UNITED STATES OF AMERICA, *Appellant*,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al.*, *Appellees*.

On Appeal from the United States District Court for the District of Columbia

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MOTION TO AFFIRM

Appellees [1] respectfully submit that the final judgment of the District Court, reported at 374 F. Supp. 95, is so plainly correct and the issues raised by appellant so insubstantial as not to require plenary review. Accordingly, appellees move, pursuant to Rules 16 (1)(c) and 16(1)(d) of the Rules of this Court, that the judgment be summarily affirmed.

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[1] This motion is filed on behalf of all defendants in the court below, except the National Association of Securities Dealers, which is filing its own motion to affirm, and Walston & Co. Inc., which is in bankruptcy.

QUESTIONS PRESENTED

The Investment Company Act of 1940[2] created a pervasive scheme of Securities and Exchange Commission ("SEC") regulation over the sale and redemption of mutual fund shares. By that Act, Congress expressly substituted a system of mandatory resale price maintenance, coupled with protections against excessive sales charges, in place of unlimited retail price competition in the sale of fund shares. As an integral part of the statutory resale price maintenance system, Congress also expressly authorized the mutual fund industry to employ contractual restrictions on the transferability of fund shares, provided that such restrictions are disclosed to the SEC and do not contravene SEC rules or regulations.

For over thirty years the mutual fund industry has complied with the statute's mandatory resale price maintenance requirements and has imposed contractual restrictions on transferability which have been fully disclosed to, and not prohibited by, the SEC. The entire price maintenance system, including the contractual restrictions, has operated under the daily scrutiny of the SEC and of the industry's congressionally authorized self-regulatory body, the National Association of Securities Dealers, Inc. ("NASD"). The NASD itself has operated under an umbrella of detailed SEC supervision and has supplemented close SEC regulation of the most minute aspects of the sale and redemption of mutual fund shares.

Only recently (1970) Congress concluded an extensive review of this statutory system of resale price maintenance. As a result of this review, Congress

[2] 54 Stat. 789, 15 U.S.C. §§ 80a-1, *et seq.*

amended[3] the Investment Company Act to strengthen protections against excessive sales charges and determined *not* to disturb the resale price maintenance system pending further SEC study on the potential economic impact of a removal of restrictions against competition. During these congressional proceedings and thereafter, proponents of unrestricted price competition in the sale of mutual fund shares—including, most notably, the Antitrust Division of the Justice Department—unsuccessfully urged repeal of the 1940 statutory scheme or, alternatively, administrative action by the SEC to prohibit the industry's competitive restrictions. Having failed to achieve its objective in Congress and at the SEC, the Antitrust Division now seeks to invoke the Sherman Act to do what both Congress and the SEC, after recent exhaustive study, have thus far refused to do.

Against this background, the following questions of law were presented to the District Court:

1. Does Section 22(f) of the Investment Company Act,[4] by expressly sanctioning those transferability restrictions in mutual fund distribution contracts which are fully disclosed to and not disapproved by the SEC, thereby immunize such restrictions from antitrust attack?

2. Does Section 22(d) of the Investment Company Act,[5] by requiring resale price maintenance in the sale of mutual fund shares (under the sanction of

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[3] Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1314.

[4] 15 U.S.C. § 80a-22(f), quoted at page 15, *infra*.

[5] 15 U.S.C. § 80a-22(d), quoted at page 19, *infra*.

criminal penalty), thereby immunize those who obey the statutory command from antitrust attack?

3. Do the Investment Company Act and the Maloney Act,[6] by granting the SEC exclusive jurisdiction to permit or prohibit restrictions on the manner in which mutual fund shares are sold and redeemed, to control the industry self-regulatory activities of the NASD, and to regulate the flow of mutual fund market information to dealers and the public, thereby immunize those who comply with SEC regulation from antitrust attack?

The court below answered each question in the affirmative. The only issue raised by this motion is whether there is any substantial question as to the correctness of the decision of the court below so as to require plenary review by this Court.

STATEMENT OF THE CASE

A. The Historical Background of the Investment Company Act.

Prior to 1940, shares in open-end investment management companies, popularly called "mutual funds," were sold very much as they are sold today. That is, an investment company or "fund" is created, and shares representing proportional ownership of the fund's portfolio of securities and cash are distributed by principal underwriters. Rather than hire their own salesmen, many underwriters enter into distribution contracts with securities dealers, who agree to sell shares in the fund at retail in return for a percentage of the sales commission or "load." The load is a fixed amount added to the net value of the assets underlying the shares to form the public offering price.

[6] 15 U.S.C. § 78o-3.

Two unique characteristics distinguish mutual fund shares from ordinary corporate securities. First, mutual funds are required by the Investment Company Act to redeem their shares at any time at the approximate net asset value.[7] Second, as a corollary to the redemption obligation, the underwriting of most mutual fund shares is continuous and of unlimited duration. Only last term in *United States* v. *Cartwright,* 411 U.S. 546, 547 (1973), this Court acknowledged the uniqueness of mutual fund shares:

> Unquestionably, the unique characteristic of mutual funds is that they are permitted, under the [Investment Company] Act, to market their shares continuously to the public, but are required to be prepared to redeem outstanding shares at any time.

During the 1930's, this process of continuous distribution and redemption was threatened by development of a secondary or so-called "bootleg" market.[8] Dealers without distribution contracts purchased and sold mutual fund shares at prices which differed from those that obtained in the contractual, or primary, distribution-redemption system. By accepting smaller sales commissions, these non-contract dealers were able to undersell the funds' regular contract dealers. Thus, the "bootleg market" fostered price-cutting by the bootleggers and discriminatory or preferential treat-

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[7] 15 U.S.C. § 80a-22(e).

[8] SEC, Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, 76th Cong., 1st Sess. 865 (1939); SEC, Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 219 (1966) (hereinafter "Public Policy Report").

ment among investors, and it interfered with the orderly process of continuous distribution through contract dealers. Some regular dealers cancelled their contracts rather than compete with the bootleg market.

In the late 1930's, the funds, their underwriters, and contract dealers sought to counter this "bootleg" market which was jeopardizing the primary distribution system. Members of the industry, including at least one appellee here,[9] inserted in their sales agreements provisions requiring dealers to purchase fund shares from the underwriter and sell them to customers at the current public offering price, which included a fixed sales load. The dealers were also required to participate in redemptions of shares at no additional charge to the customer, and they were prohibited from buying and selling shares for their own account.

In 1940, Congress incorporated this industry effort to combat the "bootleg" market as an integral part of the overall regulatory plan of the Investment Company Act. In Section 22(f) thereof, Congress authorized, subject to SEC contravention by specific rule or regulation, the very same kind of contractual restrictions aimed at the "bootleg" market which are complained of in this case. To further alleviate any "bootleg" market impact on the orderly distribution-redemption process and to eliminate discrimination among investors fostered by such a market, Congress enacted Section 22(d), which requires resale price

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[9] See Affidavit of Caleb Loring, Jr., ¶¶ 5-7, and exhibits thereto, filed by appellee Crosby Corporation in the court below in support of its motion to dismiss.

maintenance in *all* public sales of a fund's shares. Unquestionably, the intent and effect of this legislative scheme was to insulate the sale and redemption of each fund's shares from competitive market forces.

B. Post-1940 Operations and Proposals for Change.

Since 1940 the industry has sold and redeemed shares in precisely the manner contemplated by the Act. Virtually all sales of mutual fund shares are made through the primary distribution system at the current public offering price set forth in the prospectus—that is, net asset value plus the prescribed sales commission or "load." Practically all customers wishing to dispose of their shares redeem them with the fund at net asset value and without any service charge.[10] As the Court observed in *United States* v. *Cartwright, supra,* 411 U.S. at 549:

> Private trading in mutual fund shares is virtually non-existent. Thus, at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund

[10] The distribution-redemption process was described in *United States* v. *Cartwright, supra,* 411 U.S. at 547-48:

> The redemption price ("bid" price) that a shareholder may receive is set by the Act at approximately the fractional value per share of the fund's net assets at the time of redemption. § 80a-2(a)(32). In contrast, the "asked" price, or the price at which the fund initially offers its shares to the public, includes not only the net asset value per share at the time of sale, but also a fixed sales charge or "sales load" assessed by the fund's principal underwriter who acts as an agent in marketing the fund's shares. § 80a-2(a)(35). Sales loads vary within fixed limits from mutual fund to mutual fund, but all are paid to the funds' underwriters; the charges do not become part of the assets of the fund. [Footnotes omitted.]

> with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund, at the "asked" price, which includes the load. But shareholders "sell" their shares back to the fund at the statutorily defined redemption or bid price. [Footnote omitted.]

In short, Section 22 of the 1940 Act has accomplished one of its principal purposes. As a practical matter, there is no longer any secondary or "bootleg" market in mutual fund shares that might compete with and erode the contract system of primary distribution and permit price discrimination among investors. The single viable market is *"the market in mutual fund shares that the* [*Investment Company*] *Act created and regulates."* *Id.* at 557 (emphasis added).

On several occasions since 1940, the Antitrust Division has sought modification of the comprehensive price maintenance and marketing scheme created by Congress. First, the Division urged direct repeal of Section 22(d).[11] Then, the Division requested an indirect repeal of Section 22(d) through SEC exercise of its general exemptive authority under Section 6(c) of the Act[12] and its rule-making authority under Section 22(f).[13] Throughout this time, the SEC and

[11] See Hearings on H.R. 9510 Before the Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce, 90th Cong., 1st Sess. 20-2 (1967) (hereinafter "1967 House Hearings"); Hearings on H.R. 11995 Before the Subcomm. on Commerce & Finance of the House Committee on Interstate & Foreign Commerce, 91st Cong., 1st Sess. 135-36 (1969) (hereinafter "1969 House Hearings").

[12] 15 U.S.C. § 80a-6(c).

[13] See Comments of the U.S. Dept. of Justice, Hearings on Mutual Fund Distribution and the Potential Impact of the Repeal of Section 22(d), S.E.C. File No. 4-164, at 2-3, 14, 23-27 (1973); Transcript of Testimony, *id.* at 2084-086, 2089-090 (1973) (Messrs. Hunter and Grossman).

the Congress have been focusing on the very policy questions now raised by this litigation.[14] Congress has repeatedly refused to rewrite the balance struck in 1940. Indeed, in 1970 Congress reaffirmed its 1940 commitment to price maintenance, granted the NASD additional quasi-governmental, self-regulatory authority over the sale and pricing of fund shares, and requested the SEC to determine what would be the economic impact of a repeal of resale price maintenance if Congress ever were to adopt that course.

C. The Context and Commencement of This Litigation.

On November 2, 1972, the SEC announced that a preliminary staff study on the desirability and potential impact of terminating resale price maintenance in the sale of mutual fund shares had been completed.[15] Public hearings were also announced by the SEC on that question and other closely related mutual fund distribution issues.

On February 2, 1973, the Antitrust Division filed a lengthy written commentary in the SEC's Mutual Fund Distribution Hearings, File No. 4-164. While urging the legislative repeal of resale price maintenance under

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[14] See, *e.g.*, 1967 and 1969 House Hearings, *supra;* Hearings on S.1659 Before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. (1967) (hereinafter "1967 Senate Hearings"); Hearings on S.34 & S.296 Before the Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. (1969) (hereinafter "1969 Senate Hearings"); SEC, Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 4, 88th Cong., 1st Sess. (1963); SEC, Public Policy Report, *supra* (1966); SEC, Staff Report on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940 (1972).

[15] Investment Co. Act Release No. 7475 (F. Sec. L. Rep. '72-'73 Dec. ¶ 79,076 (1972). Shortly thereafter (Nov. 10, 1972), the SEC publicly released its staff study on the potential economic impact of a repeal of Section 22(d).

Section 22(d), the Division said, "Furthermore, we believe that the Commission has the power under § 6(c) of the Investment Company Act to eliminate the adverse effects of the resale price maintenance provisions of § 22(d) and need not wait for repeal. We urge the Commission to use this power." (Comments, pp. 2-3). The Antitrust Division also dealt with the suggestion that, even if Section 22(d) were repealed, the funds would be able to forestall a secondary price-competitive market by restrictions on dealers' rights to redeem shares. The Division dismissed this problem by observing, "However, the Commission could eliminate such difficulties, if they arise, by promulgating regulations prohibiting unreasonable restrictions on transferability pursuant to § 22(f) of the Investment Company Act." (Comments, pp. 13-14). In short, immediately prior to the lawsuit, the Antitrust Division publicly recognized that resale price maintenance for mutual fund shares was mandated by Section 22(d) and that, even absent legislative action, the SEC had adequate statutory authority to deal with restraints on competition in the distribution of mutual fund shares.

On February 21, 1973, the Antitrust Division, despite its written presentation in the SEC hearings less than three weeks earlier, filed this civil antitrust suit,[16]

[16] Subsequent to the appellant's suit, more than 40 private, treble-damage class actions based on similar allegations were commenced in various federal district courts and transferred to the District of Columbia by the Judicial Panel on Multidistrict Litigation. One class action had been filed in the District of Columbia in December 1972, largely anticipating the theories advanced in the appellant's case. That and one other case were dismissed by the District Court at the same time that it dismissed the appellant's complaint herein. Appeals of those two cases to the U.S.

alleging that long-existing contractual restrictions concerning the manner in which mutual funds are sold and redeemed violate Section 1 of the Sherman Act, 15 U.S.C. § 1. Counts II through VIII attacked alleged restrictions on the sale of mutual fund shares, as set forth in the fund-underwriter and underwriter-dealer agreements publicly filed in the funds' registration statements at the SEC. Count I challenged the legality of various NASD rules and regulations, alleging a horizontal conspiracy of the NASD and its members to stifle the development of a secondary "brokerage market" or secondary dealer market outside the statutorily price-fixed primary distribution system.

The District Court determined that it would first examine the basic, legal question whether the Investment Company Act exempted the alleged conduct from antitrust attack. At oral argument on defendants' motion to dismiss, the Antitrust Division abandoned its attack on the NASD's rules.[17] Thereafter, the General Counsel of the SEC advised the court of the Commission's grave concern that the suit might involve an attack on the rules of the NASD "over which the Commission is granted exclusive original jurisdiction by Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3, et seq. (the Maloney

Court of Appeals for the District of Columbia Circuit were stayed pending resolution of this appeal. The plaintiffs in one of those cases have just petitioned this Court for a writ of certiorari before judgment in the court of appeals, purportedly pursuant to this Court's Rule 20. *Gross* v. *National Ass'n of Securities Dealers, Inc., et al.*, No. 73-1968. The remaining private actions have been stayed by the District Court pending the three appeals.

[17] Transcript of oral argument at 43, 57, 60, 75-6, 83-4.

Act)."[18] Prior to the District Court's decision, the Antitrust Division confirmed its abandonment of those portions of Count I of its complaint which attacked NASD rules.[19]

D. The Decision Below.

On December 14, 1973, the District Court entered final judgment granting the appellees' motion to dismiss the appellant's complaint on the three grounds identified earlier (pages 3-4, *supra*). First, as regards the question of resale price maintenance, the court concluded "that competition in the sale of a single fund's shares is effectively precluded by the 1940 Act which was intended, via § 22(d), to prevent the sale of fund shares at a price less than that fixed in the current prospectus." 374 F. Supp. at 108; App. A55.[20] Second, as regards the challenged restrictions on transferability in the distribution agreements, the court concluded that "by § 22(f) Congress specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rule-making authority of the SEC." *Id.* at 109; App. A57. The court further found "that Congress designed §§ 22(d) and 22(f) to create and protect a primary

[18] Letter from Lawrence E. Nerheim, General Counsel of the SEC, to the Honorable Howard F. Corcoran, District Judge, August 9, 1973.

[19] Letter from Bruce B. Wilson, Acting Assistant Attorney General, to the Honorable Howard F. Corcoran, District Judge. A similar concession is made in the Jurisdictional Statement (p. 26).

[20] "App. A —" refers to the reprinted opinion in the Jurisdictional Statement.

distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market." *Id.*; App. A58. Finally, as regards the pervasive regulatory authority of the SEC over the practices raised in the complaint, the court concluded:

> The Investment Company Act and the Maloney Act read together demonstrate that Congress intended to eliminate free competition in the distribution of mutual fund shares. The language of both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency. The SEC and the NASD have the statutory authority to control the area and both have in fact taken an active role. [*Id.* at 111-12; App. A62-63; footnote omitted.]

As demonstrated in the following argument, the Jurisdictional Statement raises no substantial question as to the correctness of these determinations.[21]

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[21] Despite the suggestion in the Jurisdictional Statement (p. 3) that this case involves a claimed exemption for "all possible restraints in the distribution and sale of mutual fund shares", the issues are much narrower. The complaint did not allege the existence of horizontal restrictions upon *inter*-brand competition, and no defendant below suggested that any such horizontal restriction would be exempt from antitrust challenge. This appeal involves only alleged *intra*-brand restrictions on the sale and redemption of a fund's own shares. Vigorous and unfettered inter-brand price competition has always existed among the load funds themselves; between high, low, and no-load funds; and between open-end funds, closed-end funds, and other investment media.

ARGUMENT

The Court should summarily affirm the judgment below as embodied in the carefully documented opinion of the District Court. The pendency of this appeal should not be protracted, for it detracts from the on-going regulatory activity of the SEC, the agency properly found to have jurisdiction over the challenged practices.[22]

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[22] The Honorable Ray Garrett, Jr., the Chairman of the SEC, in a public address of May 15, 1974, on "Mutual Funds: Fifty Years and Beyond," pointedly observed:

> You are aware of the fact that the Antitrust Division of the Department of Justice has challenged the present practice of most funds in this regard [price competition] on antitrust grounds, and the Solicitor General, it was recently reported, has agreed to prosecute an appeal of an adverse decision of the United States District Court in *United States* v. *NASD*. *We did not think the Antitrust Division should have proceeded on this ground under the antitrust laws, because we think the problem should be resolved as a regulatory matter under the Investment Company Act*. They have not seen fit to comport with our general views, and we may, in the end, have a definitive court determination that will bind all of us, whatever we might otherwise have done.
>
> In the meantime, our staff is still analyzing the information and arguments provided at the hearings on mutual fund distribution and trying to fashion a proposal. I understand that the staff's proposal is likely to be some middle ground between retention of all of the present practices intact, on the one hand, and the virtual repeal of Section 22(d) on the other. Without expressing any views of my own, I think this is an interesting area to explore and we look forward to receiving the staff's proposals shortly. [Emphasis added; footnote omitted.]

I. Section 22(f) Authorizes Restrictions on Transferability and Negotiability of Mutual Fund Shares That Are Disclosed to the SEC and Not in Contravention of SEC Rules and Regulations, Even Though They May Inhibit a Secondary Market for Those Shares.

The complaint alleges that the appellees confined trading in mutual fund shares to the primary distribution-redemption system for such shares by inhibiting secondary market activity and restricting contract dealers from freely transferring fund shares. It is evident, however, from the language and history of Section 22(f) of the 1940 Act, 15 U.S.C. § 80a-22(f), that Congress explicitly authorized fund share transferability restrictions which inhibit the development of a secondary market, so long as such restrictions are disclosed in the funds' registration statements and do not contravene existing SEC rules. Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statements nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Appellant concedes that Section 22(f) was concerned with the "bootleg market." Jur. St. 22. Appellant contends, however, that the Section was intended to restrict, rather than assist, the industry in its efforts to eliminate a secondary market. *Id.* 22 n.24. The language and history of Section 22(f) thoroughly discredit the appellant's view.

When the bill which became the 1940 Act was under consideration, Congress was confronted with the practices of noncontract dealers operating in the "bootleg" secondary market and competing in price against the primary market distributors. Underwriters and contract dealers had been endeavoring to counteract the deleterious effects of the bootleg market by imposing contractual restrictions on negotiability and transferability of mutual fund shares.[23] While recognizing the significance of the restrictions in meeting the problems of the bootleg market, the SEC noted that the restrictions might eliminate "a big portion of the owner's right of initiative."[24]

The forerunner of present Section 22(f) was Section 22(d)(2) of the original SEC-sponsored bill (S. 3580, 76th Cong.), which authorized the SEC to "prohibit" by rules and regulations "restrictions upon the transferability and negotiability" of fund shares. Testifying in favor of Section 22(d)(2), the SEC's Chief Counsel, David Schenker, described existing limitations on transferability as "restriction[s] on alienability." He urged that such serious inhibitions "ought to be a matter of rules and regulations."[25] Thus, original Section 22(d)(2) was directly concerned with the sec-

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[23] See SEC, Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, 76th Cong., 1st Sess. 865 (1939); SEC, Public Policy Report, *supra*, 219 (1966).

[24] Hearings on S. 3580 Before a Subcommittee of the Senate Comm. on Banking & Currency, 76th Cong., 3d Sess 292 (1940), where the SEC's spokesman discussed the predecessor of Section 22(f), originally numbered § 22(d)(2), and its coverage of restrictions on transferability, saying: "It presents a whole problem which they call the bootleg market." *Id.*

[25] *Id.* 293.

ondary market and drafted against the background of existing private transferability restrictions which had been devised so as to restrict, if not to eliminate, that market.

In Section 22(f), as finally enacted, Congress accepted SEC regulation of these restrictions, but with one important modification. Instead of merely granting the SEC power to prohibit these restrictions, as provided in the original bill, Congress affirmed the funds' right to restrict share transferability so long as the restrictions are disclosed in the funds' registration statements and do not contravene SEC rules or regulations. The funds' power under Section 22(f) is complete and is not limited to primary distribution activities. It extends to all transfers of fund shares, whether effected in "dealer" or "broker" transactions.

The SEC has consistently administered the 1940 Act in accordance with this construction of Section 22(f). The SEC has been reminded repeatedly of the restrictive uniform sales agreements through successive filings since 1941 of the funds' registration statements, into which the sales agreements have been incorporated as exhibits in compliance with SEC-prescribed forms.[26] The SEC has issued no rules or regulations to prohibit the restrictions in those agreements. The SEC staff has discussed the restrictions' adverse effect upon the secondary market[27] and has noted that "[o]ften the contract requires him [the dealer] to place all orders with the principal underwriter and to refrain from any

[26] 1 F. Sec. L. Rep. ¶ 7177 Item 1 (Form S-5); 3 F. Sec. L. Rep. ¶ 51,296 Item 6 (Form N-8B-1).

[27] SEC, Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 4, 88th Cong., 1st Sess. 98 (1963).

attempt to obtain shares from other sources,"[28] which is just the sort of restriction attacked in the case at bar. The SEC Commissioners themselves have focused upon the meaning and legality of the restrictions on fund share transferability. Indeed, in one instance Commissioner Loomis, a former SEC General Counsel, referred to the "perfectly lawful requirement in the dealer agreements that applicant act as a dealer," and expressed his view that there was nothing "unlawful" about this "generally accepted form of dealer agreement."[29]

Because the SEC, which was designated by Congress as the sole judge of the propriety of these restrictions, has been continuously aware of them, and because the congressional requisites for their validity have been met, there is no warrant for another governmental agency to encroach upon the SEC's judgment by applying the prohibitions of the Sherman Act to these restrictions.

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[28] SEC, Staff Report on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, Pt. I, 24 (1972) in F. Sec. L. Rep. Report No. 450, Pt. II at A-109.

[29] *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 at 7 (1972) (Commissioner Loomis, dissenting on other grounds); see also *First Multifund of America, Inc.*, F. Sec. L. Rep. '70-'71 Dec. ¶ 78,209 at p. 80,602 (1971).

II. The Mandatory Price-Fixing Provisions in Section 22(d) Were Intended To Protect the Primary Distribution System and To Prevent Price Discrimination Among Investors Which Would Result from a Secondary Market.

A close companion to Section 22(f) is Section 22(d) of the 1940 Act, which requires resale price maintenance for fund shares. It provides in pertinent part:

> No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at the current public offering price described in the prospectus. * * * *

Like Section 22(f), Section 22(d) was a response to the "bootleg" secondary market which the SEC had described to Congress in these terms:

> The so-called "bootleg market" was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors for those companies. These dealers would often offer a little more than the published redemption price and ask a little less than the published sale price. In an active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering

> price. Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company. [SEC, Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, 76th Cong., 1st Sess. 865 (1939) (footnotes omitted).]

During the initial 1940 Senate hearings on the Investment Company Bill, the mutual fund industry expressed dissatisfaction with various features of the measure. Apparently as one means of solving its bootleg market problem, the industry proposed an amendment to Section 22 of the bill to provide that "no securities issued by an investment company *shall be sold* to insiders or *to anyone* other than an underwriter and dealer except on the same terms as are offered to other investors."[30] At congressional urging, the industry and the SEC worked out a compromise bill (S. 4108) which included the industry's across-the-board price-fixing proposal, now section 22(d).[31] The House version of the revised bill, with amendments not material here, was enacted.[32]

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[30] See Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking & Currency, 76th Cong., 3rd Sess. 1057 (1940) (remarks of Mr. Bunker) (emphasis added) (hereinafter "1940 Senate Hearings").

[31] See Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate & Foreign Commerce, 76th Cong., 3rd Sess. 63 (Statement of SEC Chairman Healy), 71-3 (statement of Mr. Bunker) (1940) (hereinafter "1940 House Hearings"); 86 Cong. Rec. 10069-10071 (Aug. 8, 1940) remarks of Sen. Wagner and Sen. Taft).

[32] The House reported out H.R. 10065, which differed in only minor respects from S. 4108 passed by the Senate. H.R. Rep. No. 2639, 76th Cong., 3rd Sess. (1940). The Senate agreed to the House

Thus, in approving Section 22(d), Congress responded to the urging of the mutual fund industry to protect its primary distribution system from the cut-price competition of a secondary market and to protect investors from the discrimination fostered by such a market.

In 1967, while reviewing the origin of Section 22(d) in this context of "bootleg" market price-cutting, the SEC advised Congress:

> Section 22(d) * * * has undoubtedly done much to shape the mutual fund industry into its present form.
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> * * *
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> Such competition as existed in the pre-1940 period seems to have had a truly disruptive effect on the relations between principal underwriters and contract dealers * * *. [1967 House Hearings, *supra,* 59.]

The specific purposes of Section 22(d) have been described by the SEC and other authorities as follows:

> (1) to insure the orderly distribution of open-end investment company shares, (2) to prevent discrimination or preferential treatment in price among members of the public, and (3) to prevent the cut-price competition which had then [prior to the 1940 Act] been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms.[33]

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version. 86 Cong. Rec. 10069-10071 (Aug. 8, 1940). In the short House hearings preceding passage, one critic of the original proposal lauded the revised bill for establishing, *inter alia,* "a method of standardizing selling practices." See 1940 House Hearings, *supra,* 78 (remarks of Mr. Traylor).

[33] Greene, "The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940," 37 U. Det. L. J. 369, 371 (1960); see *Baum* v. *Investors Diversified Services, Inc.,*

To achieve these objectives, Section 22(d) imposes a scheme of mandatory resale price maintenance without any of the voluntary features typically found in state fair trade laws. Under its strict terms, Section 22(d) does not allow a fund to open its shares to competitive intra-brand pricing. Similarly, contract underwriters and contract dealers, whatever their views on the merits of competition, are forbidden from selling a fund's shares to the public except at the fixed prospectus price for those shares. To prevent the development of an over-the-counter "bootleg" market offering shares to the public at less than the fixed price charged by a fund's regular distributors, Section 22(d) also prohibits non-contract or "street" dealers from selling except at the public offering price fixed in the fund's prospectus.[34] The only exception to the foregoing prohibition is that the fund, underwriter, and dealers may sell *inter sese* at less than the price fixed for sales to investors. Price-cutting in violation of Section 22(d) is a federal crime punishable by sub-

286 F. Supp. 914, 921-22 (N.D. Ill. 1968), aff'd, 409 F.2d 72 (7th Cir. 1969); SEC, Special Study of Securities Markets, *supra*, 98 n. 12; Simpson & Hodes, "The Continuing Controversy Surrounding the Uniform Price Maintenance Provisions of the Investment Company Act of 1940," 44 Notre Dame Lawyer 718, 719 (1969).

[34] SEC, Public Policy Report, *supra*, 220. If Section 22(d) were intended to prevent nothing more than riskless trading and dilution by fund *insiders* (as the appellant contends, Jur. St. 18), the provision would not have broadly covered *outsiders* such as "bootleg" dealers. This coverage of outsiders was intentional. When the industry proposed Section 22(d), it indicated that the language would apply to all sales "to insiders *or to anyone.*" See page 20, *supra*, (emphasis added).

stantial criminal penalties, as well as severe SEC and NASD disciplinary measures.[35]

Very recently (1967-70), Congress comprehensively reviewed nearly thirty years of industry operation under Section 22(d)—a crucial fact which the Jurisdictional Statement largely ignores. The Chairman of the SEC testified that Section 22(d) "is unequivocal":

> No person, no matter where he gets it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer. [1967 House Hearings, *supra,* 711.]

The Senate Committee on Banking and Currency twice reported:[36]

> Under this Section [22(d)], all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime.

Rather than repeal or amend Section 22(d) so as to permit competitive and discriminatory pricing in sales to investors—as the Antitrust Division, but not the SEC, had urged—the 91st Congress decided that fixed

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[35] See 15 U.S.C. § 80a-49; 15 U.S.C. §§ 78o-3(b)(5)(D), (b)(5)(E), & (b)(7); SEC, Public Policy Report, *supra,* 220-21; Hearings on S.1659 Before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. 86 (1967) (SEC Chmn. Cohen); 1967 House Hearings, *supra,* 48, 140 (SEC Chmn. Cohen); *e.g., In re Bakos,* F. Sec. L. Rep. '72-'73 Dec. ¶ 79,095 (1972); *In re Sideris,* Exch. Act Rel. No. 8816 (1970).

[36] S. Rep. No. 91-184, 91st Cong., 1st Sess., 3 U.S. Code Cong. & Adm. News 4897, 4904 (1969); S. Rep. No. 1331, 90th Cong., 2d Sess. 7 (1968).

sales loads should "continue to be protected against price competition by Section 22(d) * * *."[37] In the Investment Company Amendments Act of 1970, Congress chose to address the question of high sales loads by giving the industry further self-regulatory power, subject to SEC review. The 1970 amendments authorized the NASD to issue rules barring "excessive" sales loads, granted the NASD an antitrust exemption which would, among other things, permit NASD members to engage in a limited form of horizontal, inter-brand price-fixing by rule-making, and prescribed that the NASD's rules should "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters * * *." Section 22(b), as amended, 15 U.S.C. § 80a-22(b). Under the statutory scheme, resale prices fixed pursuant to this rule-making authority would necessarily, by reason of Section 22(d), become applicable to sales by non-contract, non-member dealers as well.

The appellant contends, however, that Section 22(d) has contained from its inception a major loophole for cut-price "transactions in outstanding shares that investors sell to other investors through a broker." [Jur. St. 14]. According to the appellant, the appellees have been in open violation of the antitrust laws since 1940, because they continued to use and to file with the SEC uniform sales agreements which prevented dealers from executing sales, in any capacity, except at the public offering price. After more than thirty years, the appellant now insists that, although dealers are subject to criminal penalties if they sell to an investor under

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[37] S. Rep. No. 91-184, *supra*, 3 U.S. Code Cong. & Adm. News 4912; H.R. Rep. No. 91-1382, 91st Cong., 2d Sess. 30 (1970).

the public offering price, they nevertheless must undertake the "brokering" of sales between investors at less than that price. In the appellant's view, an agreement not to undercut the distribution price and thereby risk a violation of Section 22(d) becomes in itself a violation of the antitrust laws.

A careful reading of the statute and its history does not support the appellant's view. For example, the omission of the word "broker" from Section 22(d) hardly "reflects a deliberate intent to exclude brokerage transactions from the price-maintenance restrictions on sales to investors contained in that section [Jur. St. 15]." If there actually had been a "brokerage" market in fund shares prior to 1940, perhaps Section 22(d) would have addressed that possibility more precisely. In practice, the pre-1940 "bootleg market" dealings of street traders and defecting contract distributors, as well as the regular dealings of contract distributors, were undertaken in a "principal" capacity on the selling side, with an "agent" sometimes representing the buying investor.[38] Today, irrespective of the terms of the uniform sales agreements, Section 22(d) effectively bars price-cutting in all such markets. Pure "brokered matches" between investors were simply never mentioned in the SEC's pre-Act literature. Yet, the sweep of Section 22(d) is certainly broad enough to require price maintenance if a dealer were to participate in such a transaction. As stated in the 1940 Senate report, the purpose of Section 22(d) was "to prohibit *the sale* of redeemable securities *to any person* other than a dealer or principal underwriter at a price less than * * * " the

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[38] SEC, Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70, 76th Cong., 1st Sess., 324-28 (1939).

public offering price. S. Rep. No. 1775, 76th Cong., 2d Sess. 16 (1940) (emphasis added).

Section 22(d) does not employ the term "dealer" in a transactional capacity sense, as the appellant contends.[39] Nor does the provision permit one to totally ignore, as appellant does, the controlling effect of the word "sell," another of Section 22(d)'s statutorily defined terms.[40] Furthermore, as the District Court pointed out, the appellant's narrow argument "ignores the price maintenance purpose of Section 22(d) and its

[39] Elsewhere in the 1940 Act, Congress used capacity-oriented language when it intended obligations to turn on a particular transactional capacity. See Sections 2(a)(8), 2(a)(17), 2(a)(29), 17(a), 17(d), 17(e)(1), 15 U.S.C. §§ 80a-2(a)(8), -2(a)(17), -2(a)(29), -17(a), -17(d), -17(e)(1). But in Section 22(d), the price maintenance obligation is operative against any person, regardless of capacity, who fits the statutory definition of "dealer," i.e., "any person regularly engaged in the business of buying and selling securities for his own account * * *" Section 2(a)(11), 15 U.S.C. § 80a-2(a)(11). There is no question that each appellee dealer here regularly buys and sells mutual fund shares in its business as contract dealer.

[40] Section 2(a)(34) defines "sell" to cover *all efforts* to effect a sale, not simply completed transactions. It includes "every contract of sale, or disposition of, *attempt or offer to dispose of*, or *solicitation of an offer to buy*, a security or interest in a security for value." (Emphasis added.) So great is the appellant's propensity to read the words "dealer transaction" into Section 22(d), that its complaint (¶¶ 13-14) declines to quote the statute directly but paraphrases it as if it included that phrase and expressly excluded "brokerage transactions." However, the appellant's fixation with the term "transaction," which does not even appear in Section 22(d), should not obscure the fact that a dealer may not even engage in an "attempt or offer to dispose of" or a "solicitation of an offer to buy" fund shares without coming under the strictures of Section 22(d).

corollary that there must not be price discrimination between similarly situated investors." 374 F. Supp. at 104; App. A47. It would be wholly inconsistent with the purposes of Section 22(d) to permit a secondary distribution network, ostensibly based on "brokerage transactions," to compete with the primary distribution system. Congress' objective of insulating the primary system from price competition emanating from outside that system is best illustrated in Section 22(d)'s prohibition against cut-price sales to investors by non-contract dealers.[41] It would be strange indeed if Congress meant to bar price competition from the one historically likely source, but not from the dealer members of the underwriting syndicate itself.

Price competition from "brokered" shares would plainly contravene one of the purposes of Section 22(d) frequently announced and enforced by the SEC—prevention of competitive inroads on the regular distribution system.[42] Appellant's argument to the contrary, based as it is on an inapposite analogy to "second-hand markets" for ordinary commodities (Jur. St. 14), is not persuasive. A mutual fund share presently in an investor's or a putative "broker's" hands is no different in intrinsic worth or in any other characteristic from a

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[41] The appellant plainly errs in contending (Jur. St. 15 n.13) that "all of [Section 22's] subsections concern transactions in or from the primary distribution chain of fund-underwriter-contract dealer-investor." Section 22(d) plainly forbids dealers outside that chain from selling shares to investors at less than the public offering price fixed for dealers in the chain. See page 22, *supra*.

[42] See, e.g., *Adoption of Rule N-22D-1,* F. Sec. L. Rep. '57-'61 Dec. ¶ 76,625 at p. 80,393 (1958); *In re Sideris, supra,* p. 2; *Investors Diversified Services, Inc.,* F. Sec. L. Rep. '57-'61 Dec. ¶ 76,699 at p. 80,620 (1960).

share undergoing primary distribution. Each can be redeemed for net asset value; shares are completely fungible.[43] Accordingly, "brokering" at less than the public offering price would be contrary to Section 22(d) because it would constitute an inroad on the primary market.

Furthermore, under appellant's view of the law, the lucky and/or sophisticated investor would receive a preferential price made possible by a fortuitous "match" with another investor (necessarily accomplished with no "sales effort" by intermediary agents)[44] while everyone else pays the fixed offering price. As was pointed out by the court below (374 F. Supp. at 105; App. A47-8), that would be contrary to the anti-discrimination purpose which the SEC has repeatedly recognized as a principal concern of Section 22(d). In adopting Rule 22d-1, 17 C.F.R. § 270.22d-1, the Commission said in 1958:[45]

> [T]he purposes of the section [22(d)] are to *prevent discrimination among purchasers* and to pro-

[43] Nor is it fair to compare, in terms of the potential impact of price competition from secondary markets, the continuous distribution and redemption of open-end fund shares with the limited-term primary distribution process for other securities. Unlike the latter, the regular fund distribution-redemption process cannot be considered "initial" (Jur. St. 6, 10, 11), as if it were expected to terminate shortly. The appellee funds have engaged in continuous distribution and redemption since before the 1940 Act, have announced no intention to close up their distribution process in the future, and are required by the Act to continue to accept redemption requests.

[44] See page 26, note 40, *supra*.

[45] *Adoption of Rule N-22D-1*, *supra*, at p. 80,393 (emphasis added); see also Inv. Co. Act Rel. No. 89 (1941); SEC, Staff Report on Potential Impact of Repeal of Section 22(d) at 294 (1972).

> vide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus. [Emphasis added.]

The SEC's concern over discrimination constituted one of the principal reasons for its decision in 1966 to recommend regulation of sales loads rather than the repeal of Section 22(d):

> [R]etail price competition would permit knowledgeable investors to purchase mutual fund shares at sales loads substantially lower than those now prevailing, but others—among them those most in need of protection—might save little or nothing. [SEC, Public Policy Report, *supra,* 222 (1966).]

In enforcement actions, the SEC has also referred to this important anti-discrimination purpose of Section 22(d).[46] Similarly, in weighing applications for exemptions from Section 22(d), the SEC has considered granting exemptions only when it is clear that unlawful discrimination will not result.[47]

The District Court correctly concluded that in the sale of mutual fund shares, price competition from any form of secondary market, including a hypothetical "brokerage" market, is precluded by Section 22(d)'s

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[46] See, *e.g.*, *In re Sideris, supra,* 2.

[47] *E.g.*, *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. 6932 at 4 (1972); *Midamerica Mutual Fund, Inc.*, 41 S.E.C. 328, 331 (1963); *Variable Annuity Life Ins. Co.*, F. Sec. L. Rep. '57-'61 Dec. ¶ 76,688 at p. 80,599 (1960).

Regarding the statutory purposes of Section 22(d) explained in these SEC decisions, we agree that "construction by an agency responsible for administering a statute it helped to draft is entitled to the greatest weight (*Zuber* v. *Allen*, 396 U.S. 168, 192) * * * [Jur. St. 19-20]." Moreover, in 1970 Congress relied upon the SEC's interpretation of Section 22(d)'s purposes and reaffirmed those purposes when it rejected repeal of the section, thus according still more weight to the SEC interpretation.

broad purposes and that restrictions on such competition are exempt from the prohibitions of the antitrust laws.

III. THE SEC EXERCISES PERVASIVE REGULATORY AUTHORITY OVER THE CONDUCT IN QUESTION AND, ACCORDINGLY, THAT CONDUCT MAY NOT BE CHALLENGED UNDER THE ANTITRUST LAWS

The decision below is supported not only by Sections 22(f) and 22(d) of the Investment Company Act and their clear rejection of ordinary antitrust prohibitions, but also by an elaborate and all-encompassing matrix of SEC regulation created by that Act and the Maloney Act of 1938, 15 U.S.C. § 78o-3. For good reason, the District Court concluded that this comprehensive regulatory system was obviously designed to displace the antitrust laws with respect to the conduct at issue. The court below acknowledged that it was "not, of course, unmindful" of this Court's view that implied displacement of the antitrust laws should be found only where direct antitrust enforcement is plainly inconsistent with the regulatory scheme. 374 F. Supp. at 113; App. A66. Accordingly, the District Court deliberately confined its holding to a "limited antitrust exemption" in the "narrow area" of conduct encompassed by this case. *Id.* at 114; App. A67. As was said in *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 385 n.14 (1973), a comprehensive regulatory scheme "may, nonetheless, in particular and discrete instances by implication grant immunity from an antitrust claim." This case is one of those "particular and discrete instances."

The SEC's extensive day-to-day supervision of each investment company's structure, conduct, financial policies, dealings with and by affiliates, periodic re-

ports, and pricing, sales, distribution, and redemption practices is thoroughly documented in the opinion below. 374 F. Supp. at 98-102; App. A34-42. In addition, the 1940 Act clothes the SEC with "authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere" in the Act. 15 U.S.C. § 80a-38(a).

Under Section 6(c) of the 1940 Act, 15 U.S.C. § 80a-6(c), the SEC may conditionally or unconditionally exempt persons, securities, or classes thereof, from any provision in the 1940 Act to the extent such exemption is in the public interest and consistent with investor protection and the purposes of the Act. The exemptive power may be exercised by orders as well as by rules and regulations. It is broader in that respect than the general exemptive power available under the Securities Act of 1933 or the Securities Exchange Act of 1934.[48] Indeed, the Antitrust Division has contended that the SEC might use its Section 6(c) authority to relieve all dealers from the price maintenance obligations of Section 22(d).[49] The SEC has not indicated that such an exemption would accord with the public interest. But if such an exemption ever were validly ordered, it might be accompanied by a rule or regulation under Section 22(f) modifying uniform sales agreement provisions which prevent sales to investors below the public offering price.[50]

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[48] *Baum* v. *Investors Diversified Services, supra,* 286 F. Supp. at 926.

[49] See page 10, *supra.*

[50] The Antitrust Division has argued that the SEC could exercise this Section 22(f) authority. See page 10, *supra.*

In addition, the SEC is empowered under the Maloney Act of 1938 and the Investment Company Act to closely regulate the affairs of the NASD and its members. The NASD is a unique industry self-regulatory association, congressionally authorized by the Maloney Act, 15 U.S.C. § 78o-3, and the Investment Company Act, 15 U.S.C. §§ 80a-22(a) and (b), to exercise quasi-governmental rule-making power over members' ordinary over-the-counter and mutual fund distribution activities. The NASD is registered with and carefully supervised by the SEC. The SEC has the authority to disapprove the NASD's Rules of Fair Practice and any changes thereto before they take effect, to abrogate part or all of any existing rules, and to issue superseding rules when necessary.

The SEC has similar power as to NASD rules issued under Sections 22(a) and 22(b) of the Investment Company Act. 15 U.S.C. § 80a-22(c). Under Section 22(a) the NASD is required to issue rules setting the minimum price at which members may buy shares from the fund, the maximum resale or redemption price for members, and their minimum holding period. Section 22(b)(1), as revised in 1970, empowers the NASD to adopt rules prohibiting members from charging "excessive" sales loads, provided that such rules "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters."[51] Clearly, then, the appellant's real goal in this lawsuit—the lowering of sales loads charged investors—is a subject already entrusted to the exclusive regulatory control of the NASD and the SEC.

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[51] A draft NASD rule regulating sales loads is presently being reviewed, on an informal basis, by the SEC staff. See Inv. Co. Act. Rel. No. 7475, F. Sec. L. Rep. '72-'73 Dec. ¶ 79,076 at p. 82,325 (1972); NASD Rel. No. 11172, F. Sec. L. Rep. '72-'73 Dec. ¶ 79,077 (1972).

Thus, this all-pervasive SEC regulatory control covers the gamut of NASD activities, including those which bear on the restraints alleged here. Not only are the NASD's rules and disciplinary actions subject to SEC approval, abrogation, and supersession, but Congress has twice declared that the antitrust laws are not operative in this area.[52] Moreover, Congress has specifically directed the SEC regarding the extent to which the SEC is to consider competitive factors in its examination of NASD rules,[53] thus making SEC review a substitute for judicial enforcement of antitrust policies.[54] Compare *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289, 302-03 n. 13 (1973). Where such exclusive agency jurisdiction exists, antitrust immunity is properly implied. *Pan American Airways, Inc.* v. *United States,* 371 U.S. 296 (1963); *Hughes Tool Co.* v. *Trans World Airlines, Inc., supra.*

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[52] Section 15A(n) of the Exchange Act, added by the Maloney Act, 15 U.S.C. § 78o-3(n); Section 22(b)(4), added by the Investment Company Amendments Act of 1970, 15 U.S.C. § 80a-22(b)(4); S. Rep. No. 91-184, *supra,* 3 U.S. Code Cong. & Adm. News 4913; H.R. Rep. No. 91-1382, *supra,* 30.

[53] 15 U.S.C. §§ 78o-3(b)(8) and 80a-22(b)(1).

[54] See *In re NASD,* F. Sec. L. Rep. '72-'73 Dec. ¶ 78,381 at 81,824 (S.E.C. 1972), aff'd without opinion, (D.C. Cir. 1973), F. Sec. L. Rep. Report No. 504 at 5 (Nov. 9, 1973); *In re NASD,* 19 S.E.C. 424, 436, 486-87 (1945); *Rules of the New York Stock Exchange,* 10 S.E.C. 270, 287-88 (1941); *cf. Federal Maritime Comm'n* v. *Aktiebolaget Svenska Amerika Linien,* 390 U.S. 238, 244 (1968). By virtue of the Investment Company Act and the Maloney Act, the SEC obviously has the comprehensive jurisdiction over the regulated parties' practices which was lacking in *City of Lafayette* v. *SEC,* 454 F.2d 941 (D.C. Cir. 1971), cited by the appellant (Jur. St. 25 n.28). Hence, here the SEC's day-to-day balancing of competitive considerations with other aspects of the public interest displaces separate antitrust adjudication.

Similarly, the allegations in paragraph 17 of appellant's complaint, concerning a purported "combination" or "conspiracy" between the NASD and its members, relate to matters fully within the SEC's exclusive regulatory authority; and, therefore, the antitrust laws do not apply. The appellant has already conceded this, in part, by abandoning the key portions of paragraph 17—an attack on the NASD rules (¶¶ 17 (a) & 17(b) and ¶ 6 of the prayer for relief).[55]

The allegation (¶ 17(c)) about inducing restrictive distribution agreements refers to a letter that the NASD sent to its membership in 1959. The letter (Gov't Ex. 18 below) advised that underwriter-dealer agreements might be amended to prevent contract dealers from taking down shares for resale to non-contract dealers. Far from having bypassed SEC procedures, as appellant claims (Jur. St. 27 n.31), the NASD letter actually relayed to NASD members *the SEC staff's view* that selling group agreements could and often did bar such transactions (see Gov't Ex. 6) and the staff's suggestion that, if they had not already done so, investment company underwriters might amend their selling group agreements to cover the point involved (see Gov't Ex. 16). The SEC staff's advice was fully consistent with that agency's continuing power under Section 22(f) to regulate transferability restrictions in registered uniform sales agreements. Moreover, the doctrine which permits private parties to join together to influence a government agency without risking antitrust liability (see *United Mine Workers* v. *Pennington,* 381 U.S. 657, 670 (1965)), surely authorizes their congressionally

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[55] See pages 11-12, *supra*.

sanctioned self-regulatory association to communicate to them the agency's response and to suggest an open and public course of action which will be fully subject to that agency's continuing scrutiny.[56]

As regards the alleged dissemination of misleading market information and suppression of market quotations by the NASD (¶¶ 17(d) & (e)), it is apparent from the foregoing discussion that the SEC has ample authority under the Maloney Act and the Investment Company Act, in addition to other statutes which it administers (e.g., Section 15(c)(2) of the 1934 Act, 15 U.S.C. § 78o(c)(2)), to deal with such practices and to conform them to the purposes of Sections 22 (d) and 22(f) of the Investment Company Act. Market information is exclusively regulated by the SEC, directly and through its control of NASD rules and bylaws.[57]

Clearly, the SEC's all-encompassing statutory and regulatory authority over the alleged practices makes this the "different case" hypothesized in *Silver* v. *New*

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[56] Unlike *Georgia* v. *Pennsylvania R.R.*, 325 U.S. 439 (1945), any changes in the sales agreement restrictions, whether or not the product of collective action, would be apparent to the SEC through public filings of the sales agreements and the amendments thereto. The market impact of such changes is fully within the control of the SEC. Under Section 22(f), for instance, the SEC has authority to disapprove any changes in the publicly filed sales agreements. Here the SEC staff actually suggested the possibility of further sales agreement restrictions.

[57] Article XVI of the NASD's bylaws governs member-dealers' computerized over-the-counter communications network (NASDAQ), and, as with all NASD bylaws, cannot be altered without SEC approval. Section 15A(b)(12) of the Exchange Act, as added in 1964, 15 U.S.C. § 78o-3(b)(12), requires the NASD to issue rules, subject to the usual vigorous SEC scrutiny, governing the form, content, manner of dissemination, and recipients of

York Stock Exchange, 373 U.S. 341 (1963).[58] In *Silver,* the SEC lacked regulatory authority over the challenged practices so as to displace the antitrust laws. Where that authority is present and is being fully exercised, however, antitrust immunity does arise. See *Gordon* v. *New York Stock Exchange,* Dkt. No. 74-1043 (2d Cir. June 28, 1974) aff'g, 366 F. Supp. 1261 (S.D.N.Y. 1973). *Gordon* held that the New York Stock Exchange's minimum rate structure was exempt from antitrust attack because of the long-standing congressional policy in favor of exchange self-regulation on matters of rates, subject to continuous SEC oversight. The instant case closely parallels *Gordon.* Whereas in *Gordon* it was said that "Congress made clear its judgment of the Commission's competence to assume the central role in assuring investor protection and exchange fair dealings," slip op. at 9, here the Maloney Act and the Investment Company

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market quotations. See, *e.g.*, NASD Rules of Fair Practice, Art. III, §§ 5-6. Investors' information continues to be channeled through prospectuses and other sales literature, all of which must be filed with the SEC and must comply with SEC disclosure guidelines on topics such as "how to purchase," "pricing," "sales charge," and "repurchase, redemption, and market for shares." 1 F. Sec. L. Rep. ¶ 7178 at pp. 6299-15 through 6299-20; 3 *id.* ¶ 48,902.

[58] Indeed, *Silver* itself cites the fact of SEC scrutiny over NASD activities to illustrate the "different case." 373 U.S. at 358 n.12. See *Baum* v. *Investors Diversified Services, Inc.,* 286 F. Supp. 914, 924-26 (N.D. Ill. 1968), aff'd, 409 F.2d 872 (7th Cir. 1969); *cf. Gordon* v. *New York Stock Exchange, Inc.,* 366 F. Supp. 1261 (S.D.N.Y. 1973), *aff'd,* Dkt. No. 74-1043 (2d Cir. June 28, 1974); *Stark* v. *New York Stock Exchange, Inc.,* 347 F. Supp. 212 (S.D.N.Y. 1972), aff'd, 466 F.2d 743 (2d Cir. 1972); *Kaplan* v. *Lehman Bros.,* 250 F. Supp. 562, 566 (N.D. Ill. 1966), aff'd, 371 F.2d 409 (7th Cir. 1967), cert. denied, 389 U.S. 954 (1967).

Act clearly give the SEC the central role in assuring protection of mutual fund investors and fair dealings by the NASD.

Underlying the *Gordon* decision was the Second Circuit's recognition that exemption from the antitrust laws is necessary to avoid "the danger clearly contemplated by *Silver,* 373 U.S. at 358, that courts and the SEC would subject exchanges to repetitive or conflicting standards." Slip op. at 9. Balancing of all aspects of the public interest "becomes far too hazardous with two hands on the tiller," *id.* at 10, particularly when the matter is presently undergoing study and contemplated change. The analogy to the instant case is perfectly clear. The Antitrust Division is seeking to have the courts judicially force abandonment of a mutual fund distribution system sanctioned by Congress and actively regulated by the SEC and the NASD. Meanwhile, the SEC is completing a study of this system and will issue recommendations for change, if warranted.[59] The SEC should not have to labor under a cloud of *ad hoc* regulation by court orders based upon purported applications of the antitrust laws.

[59] See page 14, note 22, *supra*.

CONCLUSION

The questions raised by the appellant do not require this Court's plenary review. The judgment below should be summarily affirmed.

Respectfully submitted,

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July 15, 1974

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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE UNITED STATES

OPINION BELOW

The memorandum opinion of the district court (App. 333-362), accompanying its order of dismissal (J.S. App. B, 69-70), is reported at 374 F. Supp. 95.

JURISDICTION

The memorandum opinion and order of the district court were entered on December 14, 1973. The notice of appeal to this Court (App. 363) was filed on February 11, 1974. On March 14, 1974, the Chief Justice extended the time for docketing the appeal to May 13, 1974, and the appeal was docketed on that date. Probable jurisdiction was noted on October 15,

1974 (App. 364). The jurisdiction of this Court is conferred by Section 2 of the Expediting Act, 15 U.S.C. 29.

QUESTIONS PRESENTED

The Investment Company Act of 1940 imposes a variety of restrictions upon the sale, distribution and redemption of mutual fund shares. The Act also gives specified regulatory authority over the mutual fund industry to the Securities and Exchange Commission and to associations of securities dealers registered by the Commission pursuant to the Maloney Act of 1938. Open-end mutual fund shares are sold through a principal underwriter who distributes the shares to broker-dealers, most of whom are members of the National Association of Securities Dealers, Inc., the only registered association. Section 22(d) of the Investment Company Act permits the fund to specify the price at which its shares may be sold by the fund, the fund's principal underwriter, or dealers to investors or persons other than a principal underwriter or a dealer. Section 22(f) prohibits a mutual fund from restricting the transferability or negotiability of its shares except in conformity with an applicable registration statement and such rules as the Commission may have adopted.

The questions presented are:

1. Whether the resale price maintenance required in primary distribution by Section 22(d) also by implication exempts from the antitrust laws combinations and agreements to suppress competition in secondary markets for already outstanding mutual fund

shares involving sales between dealers or sales between investors made through brokers.

2. Whether Section 22(f) creates an exemption from the antitrust laws for such combinations and agreements.

3. Whether the Investment Company Act and the Maloney Act create a regulatory scheme so pervasive and inconsistent with the antitrust laws that it impliedly exempts all possible restraints in the distribution and sale of mutual fund shares.

STATUTES INVOLVED

Section 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, provides in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal * * *.

Sections 22(d) and (f) of the Investment Company Act of 1940, 54 Stat. 824, as amended, 15 U.S.C. 80a-22(d) and (f), provide in pertinent part:

> (d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal un-

derwriter, or the issuer, except at a current public offering price described in the prospectus. * * *

(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Sections 15A(b)(8) and (n) of the Securities Exchange Act of 1934, 48 Stat. 895, as added by Section 1 of the Maloney Act of 1938, 52 Stat. 1070, as amended, 15 U.S.C. 78*o*–3(b)(8) and (n), authorizing securities associations registered with the Commission to engage in a degree of self-regulation, subject to specified review by the Commission, provide:

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

* * * * *

(8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimi-

nation between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

* * * * *

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail.

STATEMENT

The United States initiated this civil antitrust action under Section 4 of the Sherman Act, 15 U.S.C. 4, seeking injunctive relief against the appellees' violations of Section 1 of that Act, 15 U.S.C. 1. The defendants are the National Association of Securities Dealers, Inc. ("NASD") and certain mutual funds,[1] mutual fund underwriters,[2] and securities broker-dealer,[3] all appellees here. The complaint alleges that, in violation of Section 1, the defendants have combined and agreed to restrict the sale and fix the resale prices of the shares of open-end mutual funds in "secondary market" transactions between dealers, or from an investor to a dealer (collectively the "secondary dealer"

[1] Massachusetts Investors Growth Stock Fund, Inc.; Fidelity Fund, Inc.; and Wellington Fund, Inc.

[2] The Crosby Corporation; Vance, Sanders & Co., Inc.; and The Wellington Management Company, Inc.

[3] Merrill Lynch, Pierce, Fenner & Smith, Inc.; Bache & Company, Inc.; Reynolds Securities Corp.; F. I. du Pont, Glore Forgan, Inc.; E. F. Hutton, Inc.; Walston & Company, Inc.; Dean Witter & Company, Inc.; Paine, Webber, Jackson & Curtis, Inc.; and Hornblower & Weeks—Hemphill, Noyes, Inc.

or "interdealer" market), and between investors through a broker (the "brokerage market"). Complaint, App. 3–20. The district court granted appellees' motion to dismiss the complaint "on the merits and with prejudice for failure to state a claim upon which relief can be granted" (J.S. App. B, 69–70).

A. THE MARKETS FOR OPEN-END MUTUAL FUND SHARES [4]

This case involves alleged restraints on transactions in "open-end" mutual fund shares initially subject to a sales commission or "load." [5] A mutual fund is a company that invests in the securities of other corporations. An open-end investment company issues "redeemable securities" (15 U.S.C. 80a–5(a)(1)), which entitle the owner of the security to receive from the fund, on demand, his proportionate share of the fund's current net assets or the cash equivalent thereof. 15 U.S.C. 80a–2(a)(32). Transactions in mutual fund shares can occur in two markets: a primary distribution market and a secondary market.

1. *Primary Distribution.* In their initial or primary distribution chain, new shares issued by a fund are distributed through its principal underwriter (often an affiliate of the fund) to dealers with whom the un-

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[4] The descriptions of the markets involved are based largely upon the allegations of the complaint (¶¶ 3, 9–14, App. 4–5, 7–9), which must be taken as true (see p. 17, *infra*).

[5] There are also "closed-end" investment companies, whose shares are not redeemable and traditionally are traded in the public market at substantial discounts from asset value. There are a number of "no load" open-end funds, which do not operate through brokers but sell directly to investors at net asset value. This case does not involve either of those types of funds.

derwriter has sales agreements, and then to investors (Compl. ¶ 9, App. 7). Under the Investment Company Act, an "underwriter" is a person who purchases shares wholesale from the issuer for sale to dealers; a "dealer" buys and sells shares for his own account; a "broker" buys and sells, as an agent, for the accounts of others. 15 U.S.C. 80a–2(a)(6), (11) and (40).[6]

Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. 80a–22(d), requires that funds distribute their shares either to or through a principal underwriter or at a "current public offering price" described in the prospectus. If the class of security is being currently offered to the public by or through an underwriter, Section 22(d) also requires that principal underwriters and dealers adhere to the current public offering price when selling to anyone other than a dealer, a principal underwriter or the issuing fund.[7] The current public offering price is equal to the daily prorated "net asset value" of the fund's portfolio of investments, plus a sales commission ("load")

[6] The term "broker-dealer" is not defined in the Investment Company Act. It applies in the securities industry to individuals and firms that function in particular securities transactions either as a "broker" or as a "dealer." See also p. 22, *infra*, n. 17.

[7] If shares are sold by a dealer in the primary distribution chain (a contract dealer) to a dealer not in that chain (a non-contract dealer), they leave the primary distribution chain without first being sold to an investor. Section 22(d) permits However, because non-contract dealers are bound by the requirements of Section 22(d) concerning the public offering price when selling such shares to investors, this aspect of the interdealer market is in effect part of the primary distribution chain.

fixed by the fund. 15 U.S.C. 80a-2(a)(35). In recent years, commissions have generally been fixed at 8.5 percent of the public offering price (9.3 percent of the net asset value) of a share. Usually the 8.5 percent sales load is split at 1.5 percent for the principal underwriter and 7 percent for the dealer.

An investor wishing to liquidate his investment normally does so by redeeming the shares with the fund. Upon surrender, the fund pays the investor the current net asset value of the shares. Shares may also be redeemed through dealers (Comp. ¶9, App. 7).

Although they are not required by law to do so, most open-end mutual funds engage in continuous public offerings of new shares; a minority, however, have voluntarily "closed up," either intermittently or on a long term basis, by discontinuing sales of shares. SEC Staff Study, *On the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940,* A-118 to A-120 (1972) (*"SEC Staff Study"*). By contrast, all funds are legally obliged to redeem their shares at any time. 15 U.S.C. 80a-22(e).[8]

2. *The Secondary Market.* The secondary market consists of transactions in shares that have already passed through at least part of the primary distribution network. It includes an "interdealer market" and a "brokerage" market between investors. Shares bought and sold in the secondary market would ordinarily be shares already in circulation, as distin-

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[8] Holders of shares in closed-up funds often choose to sell them to broker-dealers, rather than to redeem them from the fund, in order to obtain a known price and quick cash payment, and for convenience. *SEC Staff Study* A-119.

guished from new shares in the primary distribution chain (but see p. 7, *supra*, n. 8). Consequently, the price range in the secondary market is limited by the primary market price and the redemption value of the shares.

Since sellers can always redeem shares at their net asset value, they will not ordinarily sell for less. Since buyers can always obtain shares (except on the infrequent occasions when the fund is not offering them) at the current public offering price, they will not ordinarily pay more. Only the "load" or sales commission can be affected by sales in secondary markets. Since the transactions are in shares already outstanding, they cannot change the funds' per share net asset value.

A few broker-dealer firms, acting as dealers, currently make markets with other dealers in the most widely-held mutual fund shares.[9] Other dealers with customers wishing to acquire or liquidate shares can go to these firms without dealing with the fund itself or the principal underwriter.[10] This market does not ordinarily produce any monetary advantage to a "buying" investor, since Section 22(d) requires that all dealer sales to investors be made at the fixed public offering price, if the shares are currently being offered to the public by or through an underwriter.

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[9] Sales in this interdealer market accounted for less than one-tenth of one percent of total 1970 mutual fund share sales. *SEC Staff Study* A-113.

[10] Many dealers are bound, however, by restrictive agreements with principal underwriters forbidding trading on the interdealer market. The legality of these agreements is one of the issues in the present action.

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It can, however, produce an advantage to "selling" investors because a dealer may be willing to pay more than net asset value for the shares. The principal underwriter's 1.5 percent spread, which is avoided in the secondary market, offers one opportunity for dealers to pay selling investors small increments above net asset value without cutting into their own profits. Furthermore, the interdealer market may permit the selling investor to dispose of his shares more quickly and easily than by redemption through the fund or its underwriter.[11]

Brokerage market transactions, in which investors sell to one another through intermediary brokers, could likewise provide an opportunity for negotiation of a price between the public offering price (which includes the 8.5 percent load) and the net asset value (at which the fund is required to redeem), thus benefitting both parties to the transaction.[12]

B. THE ANTITRUST VIOLATIONS ALLEGED IN THE COMPLAINT

Count I of the complaint alleges that NASD and its members (including the appellee broker-dealers and underwriters) have combined to "prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares" (Compl. ¶¶ 15–18, App. 9–10). The complaint alleges that the NASD and its members have (a) established and maintained rules[13] that inhibited the

[11] *SEC Staff Study* A–110.

[12] It appears that no such brokerage actually exists today. The legality of such a market, and the factors which may have suppressed it, are at issue in the present action.

development of secondary dealer and brokerage markets; (b) induced broker-dealers and principal underwriters to enter into restrictive sales agreements designed to suppress the development of such markets; (c) distributed misleading information concerning the legality of a brokerage market and discouraged persons from participating in it; and (d) suppressed market quotations for the secondary dealer market. (See, *e.g.* GX 14–19, App. 268–280.)

Counts II through VIII allege that the appellee mutual funds and their principal underwriters and broker-dealers have "entered into and maintained contracts and combinations * * * in unreasonable restraint of the aforesaid trade * * *" (Compl. ¶¶ 22, 28, 34, 40, 46, 52 and 57, App. 10, 11–12, 13, 14, 15, 16, 17), consisting of specific contractual agreements between the broker-dealers and the principal underwriters ("sales agreements") and between the principal underwriters and their respective mutual funds ("underwriting agreements"). The sales agreements, the complaint alleges, contain restrictive provisions directed towards prohibiting the participation of the broker-dealer in competitively-priced brokerage or interdealer markets. The underwriting agreements, it is alleged, not only prohibit the principal underwriter from participating in transactions in the secondary markets, but also, in one instance, obligate the principal underwriter to require that broker-dealers, in turn, agree to such restrictions (Compl. ¶¶ 22, 23, 28, 29, 34, 35, 40, 41, 46, 47, 52, 53, 57, 58, App. 10, 11–12, 13, 14, 15, 16, 17). See, *e.g.*, App. 34–38, 44–56, 63–69, 75–87, 100–115, 121–135, 138–152, 156–224.

[13] See p. 51, *infra*, n. 47.

The results of such agreements and other concerted conduct, the complaint alleges, have been to restrict the purchase and sale of fund shares largely to a primary distribution system, to curtail or eliminate secondary brokerage markets, to fix illegally the price of those secondary brokerage transactions which have been permitted by certain funds, and to deprive the public of the benefits of free and open competition in a secondary dealer and brokerage market in mutual fund shares (Compl. ¶¶ 18, 24, 30, 36, 42, 48, 54, 59, App. 10, 11, 12, 13, 14, 15, 16, 17).

The complaint seeks an injunction prohibiting the appellee funds, underwriters and broker-dealers from including and enforcing restrictive provisions in their selling agreements, and prohibiting NASD activity designed to discourage secondary brokerage and inter-dealer markets.

C. THE DISTRICT COURT'S DECISION

On motions by the appellees filed before discovery and trial, the district court dismissed the government's complaint with prejudice (J.S. App. B, 69–70). First, the court held that "Congress designed §§ 22(d) and 22(f) [of the Investment Company Act] to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is 'incompatible with the maintenance of (an) antitrust action' " (App. 354).

Basing that holding upon its reading of the legislative history of Sections 22(d) and 22(f), the court

observed that prior to the passage of the Investment Company Act a secondary market in open-end mutual fund shares had existed—the so-called "bootleg market." Sections 22(d) and 22(f), the court said, were aimed at suppressing the "cut-price competition" in this market which had caused "discrimination between similarly situated investors" (App. 348–349, 353). The court believed this conclusion to be supported by the fact that in 1967 and 1969 Congress had been asked to repeal or modify Section 22(d) but did not do so, and the court stressed testimony from the 1967 and 1969 hearings in which several persons broadly declared that Section 22(d) prohibits all price competition in broker or dealer mutual funds transactions (App. 349–352).

Second, the court concluded that the Investment Company Act and the Maloney Act commit the supervision and control of mutual fund transactions exclusively either to the oversight regulatory authority of the Commission or to the self-regulatory power of the NASD, the latter being subject to the Commission supervision and review (App. 355–361). The court reasoned that the "pervasive regulatory scheme" of the Investment Company and Maloney Acts was intended to replace the "usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares" and results in an implied immunity for the challenged practices (App. 361). The court stated that the case presents no question of primary jurisdiction (App. 361, n. 59).

SUMMARY OF ARGUMENT

In Section 22 of the Investment Company Act of 1940, Congress carefully defined the circumstances in which the shares of mutual funds may be the subject of resale price maintenance. It intended that at the end of the primary chain of distribution of such shares from the fund to investors, through underwriters and dealers, there be only one price to all investors (including "insiders" connected with the fund), consisting of the daily *pro rata* net asset value of the shares plus a fund-prescribed commission. Interdealer transactions were expressly excluded from the resale price maintenance requirements of Section 22(d), nor were sales between investors through brokers covered. Congress thus "marked the limitations beyond which price fixing cannot go." *United States* v. *McKesson & Robbins, Inc.*, 351 U.S. 305, 316. The courts "are not only bound by those limitations, but * * * are bound to construe them strictly, since resale price maintenance is a privilege restrictive of a free economy." *Ibid.*

The complaint alleges that the appellee funds, underwriters, and dealers, by an elaborate system of agreements and understandings arranged through appellee NASD and by other means, have sought to prevent the establishment of any secondary market in mutual fund shares, consisting either of transactions between dealers or transactions between investors made through brokers. This collective foreclosure of a secondary market goes beyond the purpose of Section 22, which was, by assuring a single public price to all investors buying newly issued shares, to prevent

discriminatory insider trading and dilution of asset value. A secondary market for already outstanding shares cannot aid insiders or dilute the funds' net asset value. Such a market can, however, provide an alternative method for investors to buy and sell outstanding shares at more favorable commission rates.

The appellees' restrictive agreements barring their participation in competitive secondary markets have not been approved by the Commission and, in any event, are not authorized by Section 22(f) of the Investment Company Act, which prohibits a mutual fund from restricting the transferability or negotiability of its shares except as outlined in that section. Not only do the challenged agreements go beyond the restrictions covered by Section 22(f), but that provision was not intended to supplant the prohibitions of the antitrust laws. Rather, it supplements other legal limitations that might be applicable to such restrictions.

By going beyond the narrow scope of conduct authorized by Section 22, appellees have violated Section 1 of the Sherman Act, the principal guarantee of this nation's fundamental commitment to competitive free enterprise. Nothing in the language or history of the Investment Company Act or the Maloney Act supports the district court's view that Congress intended an exemption from the antitrust laws broader than those acts expressly provide. On the contrary, the district court failed to give weight to two well-established doctrines: that repeals of the antitrust laws by implication are disfavored, and that exemptions for activities

subject to direct government regulation, or to a statutory duty of self-regulation, are implied only to the extent necessary to make the regulatory acts work, and even then only to the minimum extent necessary. *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321, 350–351; *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 315–316; *Silver* v. *New York Stock Exch.,* 373 U.S. 341, 357.

ARGUMENT

I. THE UNQUALIFIED SUMMARY DISMISSAL OF THE GOVERNMENT'S ANTITRUST CLAIMS WAS IMPROPER

A complaint should not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley* v. *Gibson,* 355 U.S. 41, 45–46.[14] Summary dismissal is particularly inappropriate in antitrust cases alleging conspiracies (*Poller* v. *Columbia Broadcasting Sys., Inc.,* 368 U.S. 464, 473), involving developing areas of law (cf. *White Motor Co.*

[14] Although appellees moved to dismiss on the ground that the government's complaint failed to state a claim upon which relief can be granted, several appellees appended exhibits to their supporting memoranda and the government filed an affidavit describing certain attached documents in support of the allegations in its complaint. The district court's opinion referred only to the allegations of the complaint. If the motions are treated as if for summary judgment, because of the introduction of matters outside the pleading (Fed. R. Civ. P. 12(b), (c)), the material allegations of the complaint must be taken as true, as with a motion to dismiss, and the inferences to be drawn from the underlying facts contained in the additional materials must be viewed in the light most favorable to the government. *United States* v. *Diebold, Inc.,* 369 U.S. 654, 655. In any event, it would have been inappropriate to grant summary judgment before the government had completed discovery.

v. *United States,* 372 U.S. 253, 259–261) or presenting claims that particular restrictions are necessary to achieve the purposes of a regulatory statute. *Silver* v. *New York Stock Exch., supra,* 373 U.S. at 356–357. Without a factual record, the extent of the immunity based on such claims cannot be readily determined at the pleading stage. *Scheuer* v. *Rhodes,* 416 U.S. 232, 250; *Harwell* v. *Growth Programs, Inc.,* 451 F. 2d 240, 246–247 (C.A. 5), modified, 459 F. 2d 461, certiorari denied, 409 U.S. 876.

The complaint, whose allegations must be read in the light most favorable to the pleader upon consideration of a motion to dismiss (*e.g., Scheuer* v. *Rhodes, supra,* 416 U.S. at 236–237), states that the agreements between mutual funds and their principal underwriters, or between a principal underwriter and broker-dealers, are designed to restrict the development of secondary interdealer and brokerage market in mutual fund shares, and that the members of the NASD have engaged in a concerted effort to encourage the use of such restrictions and to suppress those secondary markets.

The collusive activity described in the complaint amounts, *inter alia,* to a boycott of secondary market brokers and dealers. Group boycotts or concerted refusals by traders to deal with other traders are *per se* violations of Section 1 of the Sherman Act, without regard to their effect upon the price, quantity or quality of the goods or services offered to the public. *Fashion Originators' Guild of America, Inc.* v. *Federal*

Trade Commission, 312 U.S. 457, 465–468; *Klor's Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207, 211–212.

Similarly, the challenged sales agreements and underwriting agreements restricting the participation of broker-dealers and principal underwriters in competitively-priced brokerage or interdealer markets constitute resale price maintenance agreements and customer restraints which *per se* violate Section 1 of the Sherman Act (*United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 372–373, 377–378; *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373, 407–409), even without proof of their effect upon prices or volume in secondary markets. See *United States* v. *Arnold, Schwinn & Co., supra*, 388 U.S. at 379; *United States* v. *McKesson & Robbins, Inc., supra*, 351 U.S. at 309–310.

Given the allegations of the complaint that, as the result of such contracts and other concerted activity, the purchase and sale of mutual fund shares have been confined largely to a primary distribution system, that secondary markets have been curtailed or eliminated, and that secondary market brokerage transactions have occurred at illegally fixed prices, the dismissal can be sustained only if Congress intended in the Investment Company Act and the Maloney Act to provide antitrust immunity for virtually any state of facts relating to suppression of competition in secondary markets that the government might prove. As we next show, Congress had no such intention.

II. SECTION 22(d) OF THE INVESTMENT COMPANY ACT DOES NOT AUTHORIZE THE CHALLENGED RESTRICTIONS ON A SECONDARY BROKERAGE OR INTERDEALER MARKET IN MUTUAL FUND SHARES

The district court concluded that a secondary market consisting of inter-investor and interdealer transactions could not coexist with the resale price maintenance mandated for the primary market. It held that "creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urged upon Congress with no success" (App. 345–346). From this premise the court concluded that Section 22(d) by implication repeals Section 1 of the Sherman Act as applied to collective suppression of secondary markets.

The court's premises are erroneous for a number of reasons. Repeal of Section 22(d) would involve opening the *primary* market to price competition. That is quite a different question from the question of the present effect of Section 22(d) on a *secondary* market. No relevant inference can be drawn, therefore, from Congress' refusal to repeal that provision *in toto.*

The language of Section 22(d), as it now stands, permits a secondary market. The legislative history confirms this, for it shows that Section 22(d) was addressed to abuses in the primary distribution of

mutual fund shares, not to secondary level transactions. Since a secondary market cannot, as the district court believed, undermine, or even adversely affect, primary distribution of fund shares at a "current public offering price," it was not a matter of concern to Congress.

Finally, the Commission has consistently ruled that Section 22(d) permits a secondary market for both brokered sales between investors, and interdealer transactions.

A. THE LANGUAGE OF SECTION 22(d) DOES NOT PROHIBIT COMPETITIVE INTERDEALER AND BROKERAGE MARKETS

Section 22(d) of the Investment Company Act requires that a mutual fund sell shares either to or through a principal underwriter for distribution or at a current offering price described in the prospectus. 15 U.S.C. 80a-22(d). It further provides in relevant part that

> if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

In thus requiring that mutual funds, underwriters and dealers, when selling shares to the public, adhere to a "current public offering price described in the prospectus," Section 22(d) authorizes vertical price fixing. With respect to those transactions described in Sec-

tion 22(d), therefore, a limited exemption from the antitrust laws must be implied. But implied repeals of the antitrust laws are disfavored and must be strictly construed (*e.g., United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 350–351; *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 316; *United States* v. *Borden Co.,* 308 U.S. 188, 198–199), so that the scope of this exemption can be determined only by noting what Section 22(d) does and does not say.

Section 22(d) expressly excepts interdealer transactions from its resale price maintenance provisions, unambiguously stating that principal underwriters and dealers are permitted to sell mutual fund shares to other underwriters or dealers or to the issuer at other than the public offering price. As the interdealer market is expressly excluded from the coverage of Section 22(d), it provides no immunity from the antitrust laws for concerted conduct and contracts restricting participation in or fixing prices on interdealer sales.

Section 22(d) does not bar direct sales between investors, and does not mention "broker" at all. On its face, therefore, it does not apply to transactions in mutual fund shares between investors executed through a broker. Congress separately defined the terms "broker" [15] and "dealer" [16] in the Investment

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[15] "'Broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." 15 U.S.C. 80a-2(a)(6).

[16] "'Dealer' means any person regularly engaged in the business of buying and selling securities for his own account,

Company Act, and used the terms individually and together in various sections of the Act.[17] Such usage indicates that Congress deliberately employed the term "broker" where it sought to cover brokers or brokerage transactions, and omitted the term where that was not its purpose. To read the term "broker" into Section 22(d) would unjustifiedly expand that provision to include brokerage transactions, in conflict with the established doctrine that statutes authorizing resale price maintenance—"a privilege restrictive of a free economy"—must be "strictly" construed. *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 316.

The reason for the omission of brokers from Section 22(d) becomes clear when the role that brokers

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through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U.S.C. 80a-2(a)(11).

[17] "Broker" is used without any reference to a dealer in Sections 2(a)(6), 3(c)(2), 10(b)(1), 17(e)(1) and 17(e)(2), 15 U.S.C. 80a-2(a)(6), -3(c)(2), -10(b)(1), -17(e)(1) and (2). "Dealer" is used without reference to broker in Sections 2(a)(29), 2(a)(40), 22(c) and 22(d). 15 U.S.C. 80a-2(a)(29), -2(a)(40), -22(c), -22(d). Both "broker" and "dealer" are used together in Sections 1(b)(2), 2(a)(11), 9(a)(1) and (2), 12(d)(3), and 30(a), 15 U.S.C. 80a-1(b)(2), -2(a)(11), -9(a)(1) and (2), -12(d)(3), and -30(a). See 54 Stat. 789, *et seq.*

When Congress amended the Act in 1970 (84 Stat. 1413), it continued to employ the terms "broker" and "dealer" together in Sections 2(a)(19)(A)(v), 2(a)(19)(B)(v), 12(d)(1)(B) and (E)(i), 15 U.S.C. 80a-2(a)(19)(A)(v) and (B)(v), -12(d)(1)(B) and (E)(i). In addition, it also used the general term "broker-dealer" in Sections 22(b)(1) and (2), 15 U.S.C. 80a-22(b)(1) and (2).

play in mutual fund transactions is considered. A broker is not a principal party in a mutual fund transaction, but rather, as the statutory definition indicates (p. 21, *supra*, n. 15), an intermediary between buyer and seller. He acts as an agent. Because parties involved in securities transactions act in different capacities at different times, Congress has carefully identified the capacities covered by its authorization of some form of price fixing.

Section 22(d) reflects this care. A broker, as agent for buyer or seller, is identified with, and controlled by the statutory restrictions applicable to, that party. For example, if a broker were to act as agent for the purchaser in a mutual fund transaction between a selling dealer and a purchasing member of the public, the transaction would be covered by the requirement of Section 22(d) that sales by dealers to anyone other than a dealer, underwriter, or the issuer must be at the public offering price.[18] A brokerage transaction between two investors (*e.g.*, members of the public) would not be covered by Section 22(d) because that section does not speak in terms of, and hence does not restrict, a sale by one investor to another.[19]

Each subsection of Section 22 concerns transactions that are links in the primary distribution of shares from fund to underwriter to dealer to investor. None

[18] If the broker is treated as agent for the investor, the transaction becomes a dealer-to-investor sale, which Section 22(d) covers.

[19] Such a sale would necessarily be part of a secondary market. The primary distribution chain would have been completed once the first investor purchased from the fund, underwriter or dealer.

indicates a purpose to reach transactions between investors, whether conducted with or without a broker intermediary. In this respect, Section 22(d) may be analogized to state fair trade laws authorizing resale price maintenance in the initial distribution of a product but not validating agreements to set prices in the second-hand market. Cf. *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384.

B. THE LEGISLATIVE HISTORY OF SECTION 22(d) DEMONSTRATES THAT IT WAS NOT INTENDED TO ELIMINATE COMPETITIVE SECONDARY MARKETS

The Investment Company Act of 1940 had its origins in the Public Utility Holding Company Act of 1935, Section 30 of which authorized and directed the Commission to study investment trusts and investment companies and to report its recommendations to Congress, 49 Stat. 837, 15 U.S.C. 79z–4. The Commission conducted a comprehensive investigation and submitted to Congress a series of detailed reports on the structure and operations of the industry and its various problems. See generally Securities and Exchange Commission, *Report on the Study of Investment Trusts and Investment Companies*, H. Doc. No. 70, 76th Cong., 1st Sess.; H. Doc. No. 279, 76th Cong., 1st Sess., pts. 1–3 (*"Investment Trust Study"*). The third of these reports was devoted to "abuses and deficiencies in the organization and operation of investment trusts and investment companies." *Investment Trust Study* iii.

Following this report, a bill was introduced in the Senate (S. 3580, 76th Cong., 3d Sess.) reflecting the views of the Commission. An identical bill was

introduced in the House (H.R. 8935, 76th Cong., 3d Sess.), but it was not the subject of hearings. Extensive hearings were held, however, on the Senate bill and counterproposals were submitted by various industry groups. See Hearings before a Subcommittee of the Senate Committee on Banking and Currency, on Investment Trusts and Investment Companies, 76th Cong., 3d Sess., pt. 1, 1–32 ("1940 Act Senate Hearings). After several weeks of negotiations, the Commission and industry representatives agreed upon the substance of revised legislation, and further hearings were held. Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce, on Investment Trusts and Investment Companies, 76th Cong., 3d Sess. ("1940 Act House Hearings"). Thereafter, substitute bills were introduced in both houses (S. 4108, 76th Cong., 3d Sess.; H.R. 10065, 76th Cong., 3d Sess.). Both bills were reported favorably by their respective committees (S. Rep. No. 1775, 76th Cong., 3d Sess. ("Senate Report"); H. Rep. No. 2639, 76th Cong., 3d Sess. ("House Report")) and the House bill, including several minor amendments, was agreed to by the Senate. 86 Cong. Rec. 10069–10071.

The purposes of the Investment Company Act are outlined in Section 1 of the Act. Sections 1(b)(2) and (3), 15 U.S.C. 80a-1(b)(2) and (3), state with respect to pricing and distribution that:

> the national public interest and the interest of investors are adversely affected—
>
> (2) when investment companies are * * * operated * * * in the interest of directors, officers, investment advisers, * * * underwriters, brokers or dealers * * * rather than in the in-

terest of all classes of such companies' security holders;

(3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities * * *.

These declarations of policy summarize the four principal abuses in pricing and distribution of mutual fund shares at which the legislative history indicates Section 22 was aimed: excessive sales loads, price discrimination between insiders and other investors, "riskless trading" and "dilution." See *Investment Trust Study* 847–874; 1940 Act House Hearings 58–59, 80–81, 99, 124; 1940 Act Senate Hearings 136–145, 187–188, 288–291, 332–336, 485, 514–527, 612, 660–663, 799–801, 836–863, 940–941, 949, 1047, 1053, 1085–1096, 1118; House Report 8, 20; Senate Report 6, 7, 16.

Section 22(b) deals with excessive sales loads. Section 22(d) was designed to correct the other three abuses. Characterized collectively as "trading against the fund" or "insider trading," these were dangerously prevalent in mutual fund trading practices prior to 1940. They were made possible by the existence of the "two-price" or "backward pricing" system of pricing mutual fund shares. *Investment Trust Study* 855–875.

Mutual fund share prices are now determined by the value of the underlying assets of the fund. (See Statement, *supra*, pp. 7–8). In the "backward pricing" system in effect prior to 1940, and to some degree until 1968,[20] the price of mutual fund shares was based

[20] See p. 29, *infra*, n. 25.

upon the value of the fund's portfolio as of the previous day's close of trading on the exchanges. This price, although determined in the late afternoon, did not go into effect until the opening of the exchanges the following morning.

In the interim period, two prices were known to the fund's operators: the present day's trading price based on the value of the fund's portfolio for the previous day, and the following day's price, based upon the portfolio's asset value for the present day. A person with access to both prices could wait until after the exchanges had closed in the late afternoon and then learn whether the following day's price would be higher or lower than the previous day's price. If the price were higher, he could buy into the fund after the exchanges had closed at the previous day's price, knowing that its shares would be selling at a higher price the following morning. An immediate redemption the following morning gave a "riskless trading" profit.[21] See, *e.g., Investment Trust Study* 865–871.

[21] A Commission witness at the Senate Hearings summarized the problems as follows (1940 Act Senate Hearings 141–142):

> "Thus, in a rising market, when the rise results in an asset increase of the share that is greater than the load that is added to cover sales commissions and profits, a person can buy a security, after the two prices are known and established, at the lower of the two prices and almost immediately turn in the share for redemption for a higher price without any chance or risk of loss; he can't lose. * * * We found in our study for September that some insiders—that is officers of the sponsors, managers and underwriters—took advantage of the two price system to buy shares before the advance price went into operation and then almost immediately redeemed them at the higher known price."

Because such transactions increased the volume of shares outstanding but produced less cash for the fund than if subject to the next day's opening price, at which the insider redeemed, this "two-price system" led to "dilution" of the per share value of stock outstanding,[22] and invited insider-trading [23] abuses. *Id.* at 865–866. Although it would not benefit the average investor, who was required to pay the full sales load or commission on purchases, to sell immediately in a rising market, since the one-day increase in the value of shares was usually less than the load paid on the purchases (*Investment Trust Study* 865), insiders often could buy at little or no load and thus could take advantage of the two-price system to purchase and almost immediately redeem without cost or risk of loss. 1940 Act Senate Hearings, 142–145, 842. It was this form of "price discrimination" between in-

[22] The Commission gave a simplified illustration of dilution shortly after enactment of the 1940 Act. See *A Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38, 41 (1941). If a fund has net assets of $100,000 with 1,000 shares outstanding, and the value of the assets doubles during market hours, the per share value will also double, increasing from $100 to $200. If 1,000 more shares are then sold at the preceding asset value of $100 per share, the appreciation in value of the old shares is "diluted," with the result that the value of each old share increases from $100 to $150, rather than to $200. If the new investor then sold his shares the next day at the $200 net asset value then in effect, the dilution effect is compounded.

[23] "Insiders" refers to officials and employees of the investment company, its investment advisor and its principal underwriter, and affiliates thereof, and any other person in a position to buy shares of a mutual fund without paying the standard sales commission.

siders and other investors that led to the requirement of Section 22(d) that any sales load be imposed on all sales, including those to insiders.[24]

Congress, the Commission and the industry recognized that there were several possible ways of preventing the inequitable dilution caused by insider trading. See, *e.g.*, Sections 22(a), 22(b) and 30(d), S. 3580, 76th Cong., 3d Sess.; 1940 Act House Hearings 99; 1940 Act Senate Hearings 141–142, 515–526, 661. For example, a system of "forward pricing" could have been adopted, under which mutual fund shares would be priced at the next-computed current net asset value of the fund.[25]

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[24] As the Senate committee report stated:

"The distribution and repurchase of the securities issued by investment companies have on occasion resulted in discrimination in favor of the management or other 'insiders' who have been able to acquire the securities and to have the companies repurchase them on a basis more favorable than that accorded public stockholders." (Senate Report 7; accord, House Report 8.)

It is in this sense, *i.e.*, discrimination between insiders and other investors, that Congress sought through the Investment Company Act to remedy the problem of "price discrimination."

[25] In 1968 the Commission adopted Rule 22c-1, 17 C.F.R. 270.22c-1, requiring forward pricing. Under the rule, all open-end investment companies must value their shares for purchases and redemptions at the next daily-computed net asset value of the fund after receipt of a purchase or redemption order. Rule 22c-1 provides:

"(a) No registered investment company issuing any redeemable security, no person designated in such issuer's prospectus as authorized to consummate transactions in any such security, and no principal underwriter of, or dealer in, any such security shall sell, redeem, or repurchase any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such

During the hearings, however, the industry strongly objected to a forward pricing system. See, *e.g.*, 1940 Act Senate Hearings 514, 523.

A second possibility for controlling "in-and-out" trading by insiders would have been to have imposed holding periods on all sales of shares to insiders (*id.* at 859). Such a requirement was advocated in the hearings and contained in S. 3580, the original bill the Commission proposed. Section 30(d) of that bill provided that the "short-swing profit" provisions of Section 16 of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U.S.C. 78p) were to apply to investment company insiders.[26] As eventually enacted, however, the Investment Company Act applied the "short-

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security for redemption or of an order to purchase or sell such security.

"(b) For the purposes of this section, the current net asset value of any such security shall be that computed on each day during which the New York Stock Exchange is open for trading, not less frequently than once daily as of the time of the close of trading on such Exchange."

This rule, adopted pursuant to Section 22(c), 15 U.S.C. 80a-22(c), specifies the basis for computing "current net asset value" where applicable. It does not apply to commission rates, nor does it purport to apply to brokered sales between investors or other secondary market transactions not covered by Section 22(d).

[26] Section 30(d) provided in full:

"Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered investment company is the issuer, or who is a director or an officer of such a company, shall be subject to the same duties and liabilities as those imposed upon certain beneficial owners, directors and officers by section 16(b) of the Securities Exchange Act of 1934."

Section 16(b) of the Securities Exchange Act allows an issuer to recover any profits obtained by officers, directors or ten percent beneficial owners as a result of any purchase and sale, or sale and purchase of the securities within any six-month period. 15 U.S.C. 78p(b).

swing profit" restrictions only to closed-end investment companies (see p. 5, *supra,* n. 6). 15 U.S.C. 80a–29(f); 1940 Act House Hearings 99.

Congress adopted a third method: the requirement of a uniform "current public offering price" on open-end fund sales to all investors. Where the fund sells through an underwriter-dealer system, this price had to include the commission or sales load. Section 22(d) embodies this alternative.

Section 22(d) had its origin in a reference during the hearings to Ohio's "blue sky law," which cured in-and-out purchasing by requiring insiders as well as all other investors to pay the full public offering price, including the sales load. 1940 Act Senate Hearings 526–527. At the conclusion of the initial hearings, the industry offered a series of proposals for legislative action (*id.* at 1052–1059), which said, with respect to Section 22 (*id.* at 1057; emphasis added):

> Distribution, redemption, and repurchase of redeemable securities, section 22 of the present bill: These sections have to do primarily with problems of dilution and excessive sales loads. As there are problems affecting distributions and transactions with dealers, all of whom are members of a securities association organized and regulated under the Maloney Act, this section should provide that the rules of such securities association may deal with this subject matter. *This section should also provide that no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors.* * * *

The underscored portion of this proposal was then incorporated in a memorandum of agreement between the Commission and industry spokesmen (1940 Act House Hearings 99) and was reflected in Section 22(d) as enacted. However, in neither the House report, the Senate report nor in any other pertinent discussion of Section 22(d) was there any mention of the secondary market in mutual fund shares.[27]

In sum, Section 22(d) was enacted to protect open-end mutual fund investors against dilution of their

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[27] The Investment Trust Study had referred to the secondary or "so-called bootleg" market primarily in one paragraph which was descriptive rather than critical and which related to the issues to which Section 22(f) rather than Section 22(d) was directed. See pp. 42–50, *infra*. This section of the Study stated, in its entirety (*id.* at p. 865; footnote omitted):

> "The so-called 'bootleg market' was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors for those companies. These dealers would often offer a little more than the published redemption price and ask a little less than the published sale price. In an active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price. Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company."

Although the secondary market in mutual funds was not unlawful, the principal underwriters who disliked it called it the "bootleg," "grey" or "price-cutting" market. *Investment Trust Study* 328, n. 85; *SEC Staff Study* A–114.

equity due to "in-and-out" trading by insiders.[28] It was never intended to, and does not, sanction the elimination of secondary interdealer and brokerage markets in which prices are set by normal competitive processes.

C. THE EXISTENCE OF A COMPETITIVE SECONDARY MARKET IS NOT INCONSISTENT WITH THE PRIMARY DISTRIBUTION SYSTEM ESTABLISHED BY SECTION 22(d)

The district court erroneously concluded that the existence of a secondary market was inconsistent with the primary distribution system established by Section 22(d) (J.S. App. 46–51). As we have just shown, Congress' purpose in enacting Section 22(d) was not to assure that a mutual fund and other elements in the primary chain of distribution of its shares were to be immune from any and all competition from secondary markets. Rather, it was to avoid dilution resulting from discriminatory pricing in favor of insiders, and unduly large sales loads. A secondary market could not contribute to dilution, whether by insiders or other investors, nor could it cause excessive sales loads.

As described above (see pp. 7–10, *supra*), the shares traded in the secondary market have already been

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[28] The role of Section 22(d) in preventing dilution from insider trading is complemented by Sections 22(a) and 22(c), which authorize the NASD and the Commission to issue rules regulating transactions between funds, underwriters and dealers in order to preclude sales below net asset value and redemptions above net asset value, which would have a diluting effect. 15 U.S.C. 80a–22(a) and (c) (see pp. 53–54, *infra*). Although dilution could still occur if the fund sold directly at a reduced price to insiders who were not NASD members, Section 22(d) prohibits such transactions.

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purchased by an investor or a dealer from a member of the primary distribution chain at the price fixed by the fund or underwriter. The fund has already received full payment for those shares. Any profits or losses as a result of their resale in the secondary market flow solely to the purchaser or seller. Investor protection against excessive profits or commissions is provided by the fact that the shares are usually available at the current public offering price and can be redeemed at net asset value.[29]

For reasons previously noted (see pp. 9–10, *supra*), the prices in a competitive secondary market are not likely to differ substantially from the price established in the primary distribution chain. While an active competitive secondary market in a fund's shares may result in somewhat lessened demand for the fund's newly-issued shares being sold in the primary distribution system, that consequence would not be inconsistent with the existence of the primary distribution system, with its resale price maintenance. Section 22 (d) was not intended to ensure that a fund would have the maximum market for its newly-issued shares, to be sold at the fixed price, any more than state fair trade laws are intended to protect producers from competition from the second-hand market for their

[29] Any brokerage commission in the secondary market would not normally exceed the difference between these two primary market prices, which is equal to the sales load determined by the fund. Since, under Section 22(b), the sales load cannot be "excessive," 15 U.S.C. 80a–22(b), the competitively-determined brokerage commission would not be so either.

goods.[30] Competition from the secondary market may to some degree limit the attractiveness of shares whose price is maintained but that does not "undermine" the legal right to practice resale price maintenance, which is all that Congress gave. In sum, existence of a competitive secondary market is not inconsistent with the resale price maintenance authorized by Section 22(d).

D. FROM THE OUTSET THE COMMISSION HAS EXPLICITLY AND CONSISTENTLY HELD THAT THE INVESTMENT COMPANY ACT PERMITS COMPETITIVELY-PRICED INTERDEALER AND BROKERAGE TRANSACTIONS IN THE SECONDARY MARKET FOR MUTUAL FUND SHARES

Shortly after the passage of the Investment Company Act, the General Counsel of the Commission issued a formal opinion that Section 22(d) did not bar brokerage and interdealer transactions in mutual fund shares:

> In my opinion the term "dealer", as used in Section 22(d), refers to the capacity in which a broker-dealer is acting in a particular transaction. It follows, therefore, that if a broker-dealer in a particular transaction is acting solely in the capacity of agent for a selling investor, or

[30] The court also erred in assuming that a secondary market would result in redemptions in excess of sales, thus forcing liquidation of the fund (App. 348). While it is true that a secondary market permits an investor to redeem shares without having purchased them from the fund, those same shares would necessarily have come from an investor who did purchase them from the fund and sold them in the secondary market rather than redeem them from the fund. In short, the fund would merely experience one sale and one redemption rather than two sales and two redemptions.

for both a selling investor and a purchasing investor, the sale may be made at a price other than the current offering price described in the prospectus. Of course disclosure of the fact that the broker-dealer is acting as agent, and of the amount of his commission, must be made to his principal or principals in accordance with the requirements of the Rules and Regulations promulgated by the Commission under Section 15 (c)(1) of the Securities Exchange Act of 1934.

On the other hand, if a broker-dealer is acting for his own account in a transaction and as principal sells a redeemable security to an investor, the public offering price must be maintained, even though the sale is made through another broker who acts as agent for the seller, the investor, or both.

As Section 22(d) itself states, the offering price is not required to be maintained in the case of sales in which both the buyer and the seller are dealers acting as principals in the transactions. [Investment Company Act Release No. 78, March 4, 1941, 11 Fed. Reg. 10992.] [31]

One month later the Commission itself noted the existence of a competitive secondary market in mutual fund shares, with no suggestion that it was barred by Section 22(d).[32]

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[31] This opinion is listed as an authoritative interpretative release in the current Commission regulations, 17 C.F.R. 271.

[32] *A proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38, 46, n. 12 (1941):

"A secondary market is maintained in shares of open-end investment companies which more closely resembles the traditional over-the-counter market in other securities, but this mar-

In 1946 the Commission adopted the General Counsel's analysis in a case dealing in part with a purchase and sale of mutual fund shares. *Oxford Co.,* 21 S.E.C. 681. Citing the 1941 opinion, the Commission expressly held that Section 22(d) did not prohibit a dealer from engaging in brokerage transactions in mutual funds shares at prices other than the current offering price (21 S.E.C. at 690; footnotes omitted):

> The requirement of Section 22(d) * * * merely provides that no *dealer* shall sell to a customer except at the sponsor's current offering price. It does not apply to broker transactions, as we have long ago advised the trade. Acting as agent for the seller or as agent for buyer and seller (with appropriate disclosure), respondent, unrestrained by Section 22(d), could and should have made the best possible deals for its customers.

In 1972, in *Mutual Funds Advisory, Inc.,* Investment Company Act Rel. No. 6932 (Jan. 12, 1972), the Commission reaffirmed this principle, stating (*id.* at 3):

> At the outset, it should be pointed out that it does not appear that applicant has standing in the circumstances of this case to seek an exemption from the prohibitions of Sections 17(a)(1) and 22(d) of the Act. Those prohibitions apply to one who sells fund shares as "principal" or "dealer" or principal underwriter. It would seem * * * that

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ket exists only in the range between the public offering price and the redemption price of the shares. Transactions in this secondary market are not prohibited by paragraph (j)(2) [proposed NASD Rule 26(j)(2)], which applies exclusively to the redemption of shares."

application would act as broker for Fundpack * * *. Thus, applicant would not come under the prohibitions in Sections 17(a)(1) and 22(d) * * *.[33]

Finally, in a recent report submitted to the Senate Committee on Banking, Housing and Urban Affairs, the Commission repeatedly emphasized that Section 22(d) does not apply to brokerage transactions in mutual fund shares. SEC, ***Report on Mutual Fund Distribution and Section 22(d) of the Investment***

[33] In April 1973, the Chief Counsel of the Commission's Division of Investment Management Regulation issued an opinion almost identical to that issued by the General Counsel in 1941 (GX 5). Responding to the question whether broker-dealers with whom an underwriter had contractual agreements could net purchase orders and orders for liquidation for the fund's shares received on the same day, this opinion affirms the viability of the Commission's earlier interpretations and states that Section 22(d) does not prohibit brokerage transactions (*ibid.*):

"In Investment Company Act Release No. 78 (March 4, 1941), the Commission's General Counsel took the position that a broker-dealer acting solely in the capacity as agent for a purchasing or selling investor is not a "dealer" for the purposes of Sections 22(d), and thus could execute a transaction, assuming full disclosure of his agency capacity, at a price other than the current public offering price described in the prospectus. The Commission later confirmed that position on the meaning of "dealer" for purposes of Section 22(d). *In the Matter of Oxford Company, Inc.*, 21 S.E.C. 681. See, also, *In the Matter of a Proposed Amendment to the Rules of Fair Practice for the NASD, Inc.*, 9 S.E.C. 38, 44, 45, Investment Company Act Release No. 118 (April 19, 1941). Accordingly, the Act does not prohibit a broker-dealer from acting as an agent with respect to a client * * *. In summary, no provisions of the Act or rules thereunder would prohibit the practice you describe."

Company Act of 1940 (1974) ("*SEC Report on Mutual Fund Distribution*").[34] The Report expressly rejected the district court's conclusions in this case that restrictions on secondary brokerage transactions are necessary to prevent discrimination between similarly situated investors and to protect the primary distribution system mandated by Section 22(d).[35] Indeed, the Commission's report found no reason to "think the

[34] The report stated that "[b]y its terms, Section 22(d) does not apply to brokered transactions. Nevertheless, no secondary market in mutual funds has developed because uniform sales agreements between underwriters and broker-dealers effectively prohibit such a secondary market" (*id.* at 109; see *id.* at 105, n. 2; 107, n. 2), although "there is no statutory requirement that the offering price in the prospectus be maintained in a brokered transaction." *Id.* at 104. The Report did not discuss the interdealer market.

[35] The Report stated (p. 104, n. 4):

"In view of the fact that by definition the secondary brokerage market in a fund's shares is not part of that fund's primary distribution system, any differences in price that may occur between the secondary brokerage market and the primary distribution market cannot be said to be the product of a discrimination by the fund between similarly situated investors. Accordingly, we are in disagreement with the court in *Haddad*, *supra* at 94, 106 insofar as that court reasoned that the Commission's prior pronouncements respecting the applicability of Section 22(d) to brokered transactions were somehow defective because those pronouncements failed to deal with the problem of discrimination between similarly situated investors.

"The Court in *Haddad* also criticized the Commission's pronouncements concerning the applicability of Section 22(d) to brokered transactions on the ground that those pronouncements did not address the effect of brokered transactions at other than the stated offering price on the regulated distribution system. * * *"

existence of a brokerage market will have a material effect on the primary distribution system." *Id.* at 104, n. 4.

Although the Commission's interpretation of Section 22(d) related only to its compatibility with the performance of brokerage functions in the secondary market, and did not sanction dealer functions there, that limitation is immaterial to the issue in this case. The significant fact is that the agency has recognized that Section 22(d) does not prohibit, but indeed favors, transactions in the secondary market at competitively fixed prices different from the initial offering price or the fund's redemption price.

The contemporaneous interpretation of a statute, consistently adhered to over a long period, by an agency involved in drafting the statute and responsible for its implementation, is entitled to great deference. *Udall* v. *Tallman,* 380 U.S. 1, 16; see *Zuber* v. *Allen,* 396 U.S. 168, 192.

The district court, which did not have available the recent Commission report, gave little weight to the foregoing Commission construction of the Act. Instead, it relied upon its interpretation of statements by Commission witnesses and members of Congress at hearings nearly 30 years after passage of the Act (App. 348–352). However, as this Court observed concerning related legislation also enacted in 1940, "[t]he intent of Congress must be culled from the events surrounding the passage of the 1940 legislation. '[O]pinions attributed to a Congress twenty years

after the event cannot be considered evidence of the intent of the Congress of 1940.'" *Securities and Exchange Commission* v. *Capital Gains Research Bur., Inc.,* 375 U.S. 180, 199–200 (citations omitted); *accord, United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 348–349. Moreover, the statements were directed, not to the application of Section 22(d) to secondary markets, which are virtually non-existent, but to the different question whether Section 22(d) should be repealed entirely, or at least modified with respect to its basic regulation of pricing in the primary distribution scheme.[36]

The district court also disregarded appellees' own past recognition, shared by commentators, that a competitive brokerage market in mutual fund shares does not violate the Investment Company Act. In a portion of the NASD's manual concerning "Maintaining the Public Offering Price," an illustrative brokerage transaction is assumed to be at less than the public offering price and is characterized as a proper transtion under Section 22(d) (NASD Manual ¶ 5269; see p. 61, n. 54, *infra*). In addition, various letters and internal memoranda (GX 12, 26, 27 and 28, App. 263–266, 296–300) further evidence appellees' knowledge of the legality of such brokerage transactions under

[36] As a recent article demonstrates, such statements, like those of prior commentators, are not supported by close analysis of the history of Section 22(d). See Heffernan & Jorden, *Section 22(d) of the Investment Company Act of 1940—Its Original Purpose and Present Function*, 1973 Duke L.J. 975.

Section 22(d). Finally, the legality of the brokerage market is acknowledged in various commentaries.[37]

III. SECTION 22(f) OF THE INVESTMENT COMPANY ACT DOES NOT IMMUNIZE CONTRACTUAL RESTRAINTS ON SECONDARY BROKERAGE OR INTERDEALER MARKETS FOR MUTUAL FUND SHARES

A. SECTION 22(f) APPLIES ONLY TO RESTRICTIONS IMPOSED BY MUTUAL FUNDS ON THE TRANSFERABILITY AND NEGOTIABILITY OF SHARES AND DOES NOT AUTHORIZE RESTRAINTS IMPOSED BY AGREEMENTS AMONG UNDERWRITERS AND DEALERS

Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

The district court held that this section "specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rulemaking authority of the SEC * * *" (App. 354) and that "Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in

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[37] *E.g.*, Motley, *Federal Regulation of Investment Companies Since 1940*, 63 Harv. L. Rev. 1134, 1145 (1950); Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940*, 37 U. Det. L.J. 369, 388, n. 79 (1960); 3 CCH Fed. Sec. L: Rep. ¶¶ 48774–48775.

full recognition of the antitrust implications" (*ibid.*). The court's conclusion, however, misinterprets both the language and legislative history of Section 22(f).

On its face, Section 22(f) contains a prohibition against any restrictions on the "transferability or negotiability" of mutual fund shares and the limited authority granted as an exception is applicable only to mutual funds themselves. A fund is authorized by Section 22(f) to impose such restrictions only if they are fully disclosed in the fund's registration statement, and, in any event, they must not contravene rules and regulations of the Commission.

The restrictions challenged in Counts II through VIII in the present case are not fund-imposed restrictions on the transferability or negotiability of shares of the sort addressed by Section 22(f). Rather, they are contractual agreements between principal underwriters and funds and between underwriters and broker-dealers. The fund shares involved in this case are, for example, "fully transferable" (GX 8, App. 254) or "transferable * * * in the customary manner" (GX 7, App. 253), as indicated both by statements in their prospectuses and by the absence of restrictions on transferability or alienability on the face of the security certificates (see p. 47, *infra*, n. 40). The contractual restrictions on distribution at issue here involve restraints of the distribution mechanism rather than restraints on the alienability or negotiability of the fund shares themselves. The shares are alienable and negotiable, but secondary markets in which to sell them have been artifically suppressed by the appellees.

Nothing in Section 22(f) sanctions the restraints challenged in the complaint. The district court's contrary assumption was based on the fact that Section 22(f) imposes conditions on the use, by funds, of restrictions on share transferability, and the requirements of full disclosure in registration statements and compliance with any rules concerning such restrictions that the Commission may adopt to protect investors (App. 353–354). The Commission has not adopted such rules, although it has stated in its recent Report on Mutual Funds (see pp. 38–39, *supra*) that it intends to do so if necessary to protect a secondary brokerage market. *SEC Report on Mutual Fund Distribution* vi.[38]

B. SECTION 22(f) MERELY PROVIDES FURTHER LIMITATIONS ON A FUND'S RESTRICTION OF THE TRANSFERABILITY OF ITS SHARES

1. The legislative history shows that Section 22(f) was intended to limit the practices of certain funds whose share certificates specified that the shares were not transferable except by redemption with the fund. Quite often these restrictions were not disclosed to investors before they purchased the shares. Because such restrictions deprived the investor of a valuable ownership right, Congress required their disclosure in the

[38] Moreover, by letter dated November 22, 1974, the Commission requested appellee NASD to amend its rules so as to prohibit agreements restricting broker-dealers from engaging in certain secondary market transactions at competitively determined prices and commission rates, in accordance with the Commission report. Letter from Ray Garrett, Jr., SEC Chairman, to Gordon Macklin, NASD President, November 22, 1974 (reprinted in Addendum to Appellee Dealers Brief). While the letter specified no time for a response, the Commission is authorized to alter the rules by its own order if NASD fails to act "within a reasonable time." 15 U.S.C. 78*o*–3(k)(2).

registration statement and authorized the Commission to regulate them. 1940 Act Senate Hearings 292–293.

The Commission-sponsored bill, which followed the Commission's report on investment company practices (see p. 24, *supra*), originally provided, in Section 22(d)(2), that the Commission was authorized, "in the public interest or for the protection of investors," to prohibit, by rule or order, "restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer." *Id.* at 16. The testimony of the Commission witness concerning this provision described the restrictions as a serious impairment of the investor's ownership rights and as a practice that should be permitted only subject to such restraints as the agency might impose to correct abuses disclosed by further study (*id.* at 292–293):

> There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. It presents a whole problem which they call the bootleg market. What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company. That is a big problem; but it seems to me they are taking away a very valuable indicium of the ability of the company, and it seems to me you are taking away a big portion of the owner's right of initiative.

* * * * *

> If this bill becomes law, and after we study the whole situation, if we feel there are abuses which cannot be corrected except by putting in a restriction on alienability, then we shall formulate rules, after discussing them with the industry.[39]

The industry counter-proposal made no reference to a provision concerning restrictions on transferability (1940 Act Senate Hearings 1057), which suggests that the industry did not regard even the relatively mild measure originally proposed as being in its interests. The Commission-industry agreement (see p. 25, *supra*) provided that "[r]estrictions on transferability of shares shall be subject to rules and regulations of the Commission." 1940 Act House Hearings 99. The Senate report stated, with respect to Section 22(f), only that the "negotiability of open-end securities may not be restricted in contravention of provisions which may be formulated * * *." *Id.* at 16. The House report described Section 22(f) as providing that "the negotiability or transferability of redeemable securities of open-end companies may not be restricted in contravention of rules and regulations which the Commission may prescribe." *Id.* at 20. Neither report referred to the secondary market in connection with Section 22(f), or suggested a general purpose to allow underwriters and dealers to make agreements concerning negotiability or transferability of shares.

2. Restrictions on the transferability of mutual fund shares, like other securities, have long been

[39] The same point was made briefly in the *Investment Trust Study* (*id.* at 865). See also p. 32, *supra*, n. 27.

subject to limitations imposed by state law as well as federal law, such as formal requirements that the restrictions appear on the face of the certificate[40] and substantive requirements that the restraints not be unreasonable.[41] Restrictions on transferability, prior to adoption of Section 22(f), would also have been subject to the general requirements of the antitrust laws. Yet, nothing in the language of Section 22(f) or its history suggests that, upon the enactment of Section 22(f), these other limitations on restrictions of transferability were rendered inapplicable to mutual fund shares.

[40] Article 8, Section 204, of the Uniform Commercial Code, which has been adopted by most states (*e.g.*, Mass. Laws Ann., C. 106, Sec. 8–204; Md. Code Ann., Art. 95B, Sec. 8–204), provides that any such restrictions, to be effective, must be noted conspicuously on the security certificate. See also Mass. Laws Ann., C. 156B, Sec. 27; Md. Code Ann., Art. 23, Sec. 27(c); 8 Del. Code, Sec. 194. Appellee funds' share certificates contain no such notice (GX 1, 2, 3, App. 233–242).

[41] Particular stock transfer restrictions contained in articles of incorporation, contracts of stock subscription and corporate by-laws have been held valid in many states, where they were limited in scope and reasonably related to corporate purposes. See *e.g.*, *Martin* v. *Graybar Elec. Co.*, 285 F. 2d 619, 624–626 (C.A. 7); *Lawson* v. *Household Fin. Corp.*, 17 Del. Ch. 343, 350–351, 152 A. 723, 727; *Brown* v. *Little, Brown & Co.*, 269 Mass. 102, 109–110, 168 N.E. 521, 525; *Searles* v. *Bar Harbor Banking & Trust Co.*, 128 Me. 34, 37–38, 145 A. 391, 393; Annot., 61 A.L.R. 2d 1318, 1324; 12 Fletcher, *Cyclopedia of Private Corporations* § 5461.3 (1971 rev.). Typical of such restrictions is a reservation by the issuing corporation of a right of first refusal on any sale of the stock. The restraints are analyzed under the common tests for trade restraints to determine whether they are reasonable ancillary restrictions to an otherwise valid voluntary contract. The restrictions, and power to impose them, are never implied, and, where express, are strictly construed. Fletcher, *supra*, § 5461.3 at 198.

Appellees have not contended that Section 22(f) preempts state law requirements, and there is no basis for such a claim. Cf. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117, 139–140. Given the similarity in standards governing preemption and implied repeal (*id.* at 126–127), there is no greater basis for the district court's conclusion (App. 353) that Section 22(f) impliedly repealed the Sherman Act, particularly in view of the established doctrine disfavoring implied repeals of the antitrust laws (see p. 21, *supra*).

C. NO NASD RULE APPROVED BY THE COMMISSION REQUIRES OR AUTHORIZES RESTRICTIONS ON TRANSFERABILITY OF MUTUAL FUND SHARES

1. The district court also noted (App. 354) that restrictive provisions have appeared in registration statements and in uniform sales agreements since 1940, and that sales agreements are required by "SEC-approved" Rule 26 of the NASD Rules of Fair Practice.[42]

While Rule 26 requires sales agreements, it does not require them to contain provisions restricting the operations of a secondary market. In fact, in issuing its "nondisapproval" of Rule 26 the Commission cau-

[42] The Commission's action was technically "non-disapproval," rather than "approval." *A Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38 (1941). However, this action does not challenge, and the injunctive relief sought would not effect implementation of, that Rule. Nondisapproval means only that the rule does not contravene 15 U.S.C. 78*o*–3(b), and does not imply that the rule is necessary to the implementation of the regulatory scheme or that it is not in contravention of any statute other than the Maloney Act. 15 U.S.C. 78*o*–3(j).

tioned that the Rule did not authorize minimum or maximum commissions, did not authorize the NASD to enforce provisions in sales agreements establishing such commisions, did not restrict dealers from buying from or selling to whomever they wish at any price (consistent, of course, with the statutory requirements of Section 22(d)),[43] and did not prohibit secondary market transactions. *A Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc., supra,* 9 S.E.C. at 44, 46.[44] Rule 26, therefore, provides no support for the district court's conclusion that contractual restrictions on competition in the secondary market were contemplated by Section 22(f) or have received the Commission's approval.

2. Nor should the Commission's delay in condemning such restrictions be construed as approval of them. Section 22(f) does not require the Commission to approve or disapprove every restrictive provision contained in a prospectus. It simply empowers the Com-

[43] The Commission stated (9 S.E.C. at 44 and n. 9):

"It is important to note the precise effect of paragraph (j)(2), the extent to which it does not restrict a dealer's activities as well as the extent to which it does. It does not prevent a dealer buying from whomever he wishes at whatever price he wishes. It does not prevent his selling to any other dealer or to any investor [9] at any price he may wish to charge. * * *

"[9] If shares of the same class are currently the subject of a public offering he is prohibited by Section 22(d) of the Investment Company Act from selling to investors at a price below the public offering price. This statutory provision, however, has nothing to do with the rule under discussion."

[44] See also p. 36, *supra*, n. 32.

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mission to make rules prohibiting restrictions, should it determine that such a rule is necessary for investor protection.[45] Like legislative inaction (*e.g.*, *Zuber* v. *Allen*, *supra*, 396 U.S. at 185–186, n. 21), administrative silence is a weak basis from which to infer agency approval of particular conduct in a regulated industry. See, *e.g.*, *Baltimore & O. Ry.* v. *Jackson*, 353 U.S. 325, 330–331.

Section 22(f) does not declare that all restrictions that have not been disapproved by the Commission are immune from the antitrust laws; nor is this a case in which the Commission has adopted rules under Section 22(f) requiring—or even authorizing—restrictions of the kind being challenged.[46]

IV. THE REGULATORY SCHEME CREATED BY THE INVESTMENT COMPANY AND MALONEY ACTS DOES NOT FORECLOSE APPLICATION OF THE SHERMAN ACT TO COLLECTIVE RESTRAINTS ON SECONDARY MARKETS IN MUTUAL FUND SHARES

A. THE REGULATORY SCHEME ESTABLISHED BY THE INVESTMENT COMPANY ACT AND THE MALONEY ACT DOES NOT MEET THE TEST FOR IMPLIED REPEAL OF THE ANTITRUST LAWS

Because the unqualified dismissal of the complaint cannot be supported by Sections 22(d) and (f) of the Investment Company Act, the remaining crucial issue in this case is whether the Investment Company and Maloney Acts create a scheme of regulation so pervasive as to constitute an implied repeal of the

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[45] Even conduct approved by an agency required to consider competitive factors is not automatically exempt from the antitrust laws (see p. 58, *infra*).

[46] Whether such rules would immunize the conduct challenged here need not be considered. Cf. *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 376–377.

Sherman Act, thereby exempting the appellees from antitrust liability for conduct which would otherwise constitute a *per se* violation of that Act.

The government complaint does not question any action taken by the Commission nor seek to overturn any NASD rule.[47] It challenges restrictive practices in an industry subject, in many aspects, to a statutory duty of self-regulation and to Commission oversight. To determine whether the legislative scheme providing for such self-regulation and oversight implies antitrust immunity, it is necessary to consider the scope and characteristics of the provisions of that scheme applicable to the sale, distribution and redemption of mutual fund shares.

1. The Maloney Act of 1938, 15 U.S.C. 78*o*–3, provides, *inter alia*, for the registration of national securities associations with the Commission. Supplementing the original provisions of the Securities Exchange Act of 1934, it provides for a degree of self-regulation of member brokers and dealers by a registered association in order "to protect the investor and the honest dealer alike from dishonest and unfair practices by the submarginal

[47] Among the things appellees allegedly did to effectuate the conspiracy to restrain trade in the purchase and sale of mutual fund shares was to establish and maintain rules that had the effect of inhibiting the development of the secondary markets (Compl. ¶¶ 15–18, App. 9–10). The government, however, is not challenging the validity of the NASD rules themselves, only the appellees' activities that have resulted in unofficial interpretations and extensions of the rules to restrict secondary markets. The rules themselves apply only to the primary distribution of mutual fund shares and do not purport to fix prices or commission rates in the secondary interdealer or brokerage markets (see p. 49, *supra*, n. 43; GX 6, 14–19, App. 251–252, 268–280).

element in the industry" and "to cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market." S. Rep. No. 1455, 75th Cong., 3d Sess., p. 3; H. Rep. No. 2307, 75th Cong., 3d Sess., p. 4.

In order to be registered, the association must have rules designed "to remove impediments to and perfect the mechanism of a free and open market," and *not* designed "to permit unfair discrimination between customers, or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." 15 U.S.C. 78*o*–3(b)(8).[48] Changes in or additions to a registered association's rules must also be submitted to the Commission and take effect only if the agency, within 30 days, does not disapprove them as being inconsistent with the requirements of the Act concerning such rules. 15 U.S.C. 78*o*–3(j). In addition, the Commission is authorized to abrogate, alter or supplement such rules if necessary to protect investors or to effectuate the purposes of the Act. 15 U.S.C. 78*o*–3(k). NASD is the only association registered under the Act.

2. The basic purpose of the Investment Company Act is to protect the "public interest" and "interest

[48] NASD rule-making under Section 22(b) of the Investment Company Act, 15 U.S.C. 80a–22(b), "in connection with a primary distribution of redeemable securities," is not subject to the price-fixing prohibitions contained in the Maloney Act.

of investors" by requiring full and fair disclosure "concerning the character of [investment company] securities and the circumstances, policies, and financial responsibility of such companies and their management" (15 U.S.C. 80a-1(b)(1)), by preventing the operation and management of such companies, and the selection of their portfolio securities, in the interests of various insiders, affiliated persons, underwriters, brokers, or dealers, "rather than in the interests of all classes of such companies' security holders" (15 U.S.C. 80a-1(b)(2)), and by preventing injury to the preferences and privileges of holders of outstanding securities. 15 U.S.C. 80a-1(b)(3). Sections 22 (a) and (c) of that Act permit NASD (as a securities association registered under the Maloney Act) and the Commission, respectively, to adopt rules regulating the minimum price at which underwriters and dealers may purchase shares from the fund, for the purpose of eliminating or reducing dilution of the value of outstanding securities, or any other result that would be unfair to holders of such outstanding securities. 15 U.S.C. 80a-22 (a) and (c). Section 22(b) permits NASD and the Commission to regulate price and sales load in connection with a primary distribution of mutual fund shares. 15 U.S.C. 80a-22(b)(1).[49]

Section 22(d) does not give NASD or the Commission any regulatory authority. Rather, it permits resale price maintenance with respect to the issuance and primary distribution of mutual fund shares. Sec-

[49] Section 22(b)(4) provides that the provisions of Section 22 (b) shall prevail over all conflicting laws of the United States. 15 U.S.C. 80a-22(b)(4).

tion 22(f) authorizes the Commission to regulate, "in the interests of the holders of all of the outstanding securities," restrictions imposed by a fund upon transferability or negotiability of its shares. 15 U.S.C. 80a–22(f). Section 6(c) authorizes the Commission to exempt any person, security or transaction from any requirement of the Act or any rule thereunder, "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. 15 U.S.C. 80a–6(c). In addition, Section 38 of the Act authorizes the Commission generally to issue rules and orders "necessary or appropriate to the exercise of the powers conferred" upon it by the Act. 15 U.S.C. 80a–37(a).

Taken together, these provisions establish a scheme of cooperative regulation, in which underwriters, brokers and dealers are free to determine for themselves what is necessary for regulation of the mutual fund distribution network, with the Commission exercising selected supplementary powers of direct regulation and secondary supervision in the interests of the investing public.

As the committee reports concerning the bill that, without material change, became the Maloney Act stated (S. Rep. No. 1455, *supra*, pp. 3–4; H. Rep. No. 2307, *supra*, pp. 4–5):

> The committee believes that there are two alternative programs by which this problem

> [of regulation of the over-the-counter market] could be met. The first would involve a pronounced expansion of the organization of the Securities and Exchange Commission * * * and a minute, detailed, and rigid regulation of business conduct by law. It might very well mean expanding the present process of registration of brokers and dealers with the Commission to include the proscription not only of the dishonest, but also of those unwilling or unable to conform to rigid standards of financial responsibility, professional conduct, and technical proficiency. The second of these alternative programs, which the committee believes distinctly preferable to the first, is embodied in S. 3255. This program is based upon cooperative regulation, in which the task will be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation. * * *

Congress thus rejected a policy of pervasive direct regulation in favor of a less intrusive scheme more in keeping with free market traditions. Within the quality control constraints imposed by the rules of the association, Congress left each fund, underwriter and broker-dealer "free to determine his own business policy" and gave the Commission power of supplementary oversight. S. Rep. No. 1455, *supra*, pp. 8–9; H. Rep. No. 2307, *supra*, p. 9; see *Investment Trust Study* 290.

3. Even when faced with regulatory schemes more extensive and intensive than the present one, this Court has refused to hold that they were so pervasive as to oust the antitrust laws from the entire area, as the district court here has held.[50] Rather, the Court has carefully examined the specific conduct in question in order to determine whether subjecting that conduct to antitrust liability would create a basic conflict with the authority of the regulatory agency. Such a conflict will justify finding a limited antitrust immunity only where three factors are present: (1) the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers; (2) the regulatory scheme must require the supervising agency to focus upon competitive considerations in exercising those powers; and (3) the agency must have express statutory authority to immunize the conduct in question from the antitrust laws. *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 385–389; *United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 351; *Pan American World Airways, Inc.* v. *United States,* 371

[50] See *Otter Tail Power Co.* v. *United States, supra; United States* v. *Philadelphia Nat'l Bank, supra,* 374 U.S. at 352; *Silver* v. *New York Stock Exch., supra,* 373 U.S. at 357; *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296, 311–312; *California* v. *Federal Power Commission*, 369 U.S. 482, 485; *United States* v. *Radio Corp. of America*, 358 U.S. 334, 350–351; *United States* v. *Borden Co., supra,* 308 U.S. at 198; *United States* v. *Trans-Missouri Freight Ass'n*, 166 U.S. 290, 314–325.

U.S. 296, 305–309. See also *Ricci* v. *Chicago Mercantile Exch., supra,* 409 U.S. at 302–303, n. 13.[51]

These requirements rest upon the importance of the antitrust laws and the policies they embody to the structure of our free economic system. See, *e.g., United States* v. *Topco Assocs., Inc.,* 405 U.S. 596, 610; *Northern Pac. Ry.* v. *United States,* 356 U.S. 1, 4–5. A general immunity from those laws ought not to be inferred unless it is clear that Congress intended to displace the protections of the antitrust laws with detailed administrative supervision or a duty of self-regulation that is necessarily inconsistent with the antitrust laws. The courts, of course, have the ultimate responsibility for determining the legislative intent in this regard (see *Ricci* v. *Chicago Mercantile Exch., supra,* 409 U.S. at 305), and must determine whether anticompetitive actions pursuant to agency supervision or a duty of self-regulation are necessary to make the regulatory scheme work, and whether they are more restrictive than necessary. *Silver* v. *New York Stock Exch., supra,* 373 U.S. at 357. The regulatory

[51] For example, in the recent *Hughes Tool* case, the conduct of Toolco that TWA alleged violated the antitrust laws had been the subject of extensive proceedings pursuant to Section 408 of the Federal Aviation Act, 49 U.S.C. 1378, resulting in the Civil Aeronautics Boards' approval of Toolco's acquisition of control of TWA. 409 U.S. at 382. Antitrust standards of competition and monopoly govern the Board's exercise of authority under Section 408 (409 U.S. at 385), and Section 414 of the Act, 49 U.S.C. 1384, expressly immunizes from antitrust liability any conduct approved, authorized or required by any Board order issued under Section 408. 409 U.S. at 386.

scheme and the antitrust laws are presumed to be complementary, not conflicting. Antitrust remedies are thus available even when an agency has supervisory powers over activities alleged to violate the antitrust laws and has considered antitrust consequences in passing on them. See *Otter Tail Power Co.* v. *United States, supra,* 410 U.S. at 373–375.[52]

4. As detailed above, neither the Investment Company nor the Maloney Act establishes a regulatory scheme meeting this Court's tests for finding implied antitrust immunity. The prerequisite conflict between the regulatory and antitrust schemes is absent.

The Commission's primary responsibility and authority with respect to mutual fund distribution is directed toward protection of investors, not restriction of competition between funds or between those who distribute fund shares. More specifically, the Commission has no authority to fix commission rates in the secondary markets, nor to prohibit brokers and dealers from trading in such markets. Its recent efforts to promote competition in the distribution of mutual funds (see pp. 38–40, *supra*) show that antitrust principles are in harmony, not in conflict, with the purposes

[52] That a statute authorizes or directs a regulatory agency to consider competitive factors in making a determination indicates that competition is relevant, but not that the agency's judgment should displace the courts' antitrust jurisdiction. See *United States* v. *Philadelphia Nat'l Bank*, *supra*, 374 U.S. 350–352 (merger approved by agency required by statute to consider competitive factors is not immunized from challenge under antitrust laws); *California* v. *Federal Power Commission*, *supra*, 369 U.S. at 487–490 (agency should await outcome of antitrust suit before deciding whether merger is in public interest).

of the Investment Company Act. Although the Commission can and should consider competition as one of the key elements which bear on fair dealing and investor protection (cf. *Gulf States Utils. Co.* v. *Federal Power Commission*, 411 U.S. 747, 757–760), it has no power to correct antitrust violations as such, or to immunize such violations from relief under the Sherman Act.

5. Appellee NASD claims that, as a self-regulatory organization granted certain powers under the Maloney Act and Section 22 of the Investment Company Act, it is immune from antitrust liability. The standard for determining the extent of antitrust immunity conferred by a self-regulatory statutory scheme was established in *Silver* v. *New York Stock Exchange, supra,* and was recently reaffirmed in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra.* Those cases emphasize that "the proper approach is to reconcile 'the operation of both statutory schemes with one another rather than holding one completely ousted.' " *Ware, supra,* 414 U.S. at 127; *Silver, supra,* 373 U.S. at 357. Therefore, absent an explicit exemption or repeal the antitrust laws may be pre-empted by a statutory scheme for self-regulation only to the minimum extent necessary to make the regulatory act work. *Ware, supra,* 414 U.S. at 127; *Silver, supra,* 373 U.S. at 357–358.

Neither the Investment Company Act nor the Maloney Act contains express exemptions from the antitrust laws for price fixing and restrictive distribution agreements designed to restrict or eliminate secondary

markets in mutual fund shares.[53] The Maloney Act only empowers the NASD to supervise the conduct of of its members in order "to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market * * *." 15 U.S.C. 78*o*-3(b)(8). The exercise of that power does not require collusive conduct to fix prices in and restrict the development of secondary markets.

Nor is the restriction of secondary markets by sellers necessary to protect investors and prevent disruption of the primary distribution system regulated by Section 22. *SEC Report on Mutual Fund Distribution* 104, n. 4. Indeed, investors are injured when they are denied the opportunity of trading in competitive markets. Any justifications there may be for fixed prices and commission rates in the primary distribution

[53] The Maloney Act contains a general provision that it shall prevail over any prior law "in conflict" with it. 15 U.S.C. 78*o*-3(n). There is, however, no conflict between the Sherman Act and any provision of the Maloney Act relevant to this case, and the district court did not rely upon this general provision. Section 22(b) of the Investment Company Act, as amended in 1970, contains a similar provision, but it is limited in scope to prior laws "in conflict" with that subsection, which concerns only the level of sales loads "in connection with a primary distribution." 15 U.S.C. 80a-22(b)(1) and (4). The limited scope of this explicit provision for *pro tanto* repeal strongly suggests that the other provisions of the Act were not regarded by Congress as presenting any problem of inconsistency with the antitrust laws or other laws.

of mutual fund shares vanish once the shares, having passed through that chain of distribution, subsequently change hands in secondary markets between dealers or in brokerage transactions.

The activities of NASD and its members cannot be characterized as good faith efforts to effectuate its statutory duty of self-regulation. In 1959 the Commission staff informed NASD that it opposed NASD's proposed interpretation of NASD Rule 26 to restrict the secondary interdealer market, as not being supported by the language or history of the Investment Company Act (GX 6, 14–19, App. 251–252, 268–280), as NASD well knew.[54] Other documentary evidence indicates that the NASD was aware that Section 22 (d) of the Investment Company Act did not bar the secondary brokerage market (GX 27, App. 298).

Even under NASD's theory, however, dismissal of the complaint was unjustified. At most, those defenses created issues of fact requiring a trial in order to

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[54] The NASD Manual, in illustrating the application of Section 22(d) and Article III, Section 25 of NASD's Rules of Fair Practice (prohibiting any member from dealing with any nonmember broker or dealer except on the same terms and conditions as are accorded by such member to the general public), recognizes that secondary brokerage transactions at less than the public offering price are permissible under both Section 22(d) and the Rule (*id.* at ¶ 5269):

* * * * *

"(All sales in the examples below are assumed to be at less than the public offering price stated in the prospectus * * *.)

* * * * *

"(9) A customer sells to another customer through a member who acts as agent for either or for both customers:

"This is a proper transaction under Section 22(d) and under Section 25 of Article III of the Rules of Fair Practice."

determine whether the appellees' conduct was in fact necessary to implement effectively the Investment Company Act and the Maloney Act, and was no more restrictive than necessary. See *Harwell* v. *Growth Programs, Inc., supra,* 451 F. 2d at 246–247.[55]

B. THE INVESTMENT COMPANY ACT AND THE MALONEY ACT DO NOT ANTHORIZE COLLUSIVE ACTION TO OBTAIN RESTRICTIONS ON THE PRICE AND DISTRIBUTION METHODS IN SECONDARY MARKETS FOR MUTUAL FUND SHARES

Count I of the complaint alleges a horizontal combination and conspiracy by NASD members to prevent the growth of a secondary dealer and brokerage market in mutual fund shares by refusing to sell mutual fund shares to dealers in the secondary market and discouraging or forbidding participation in a

[55] The district court correctly ruled that "the cases at bar do not involve the doctrine of primary jurisdiction" (J.S. App. 66, n. 59). The Commission's construction of Section 22 is clear. and the complaint does not claim that appellees have violated any statute vesting remedial jurisdiction in the Commission, or any regulation of that agency. Thus, there are no issues to refer to the Commission under the doctrine of *Ricci* v. *Chicago Mercantile Exch., supra*, and *Chicago Mercantile Exch.* v. *Deaktor*, 414 U.S. 113. As those cases make clear, the questions whether and to what extent a regulatory statute impliedly repeals the antitrust laws are ultimately to be resolved by the courts, not the agency. *Ricci, supra*, 409 U.S. at 305–306; *Deaktor, supra*, 414 U.S. at 115.

Moreover, unlike those cases, there is not any action the Commission could take here that might bear on the question whether the appellees have violated the Sherman Act or that might, by finding their activities in violation of the Investment Company Act or the Maloney Act, make a resolution of that question unnecessary.

brokerage market (Compl. ¶¶ 15–18, App. 9–10), conduct that constitutes a *per se* violation of the Sherman Act (see pp. 17–18, *supra*). Without regard to whether Section 22(f) permits a fund or its underwriter to impose such vertical restrictions on the distribution of that fund's shares, a horizontal agreement or conspiracy among competing funds, underwriters or dealers to impose restrictive provisions would be illegal under *Georgia* v. *Pennsylvania R. Co.,* 324 U.S. 439, 459–460.

There the Court held illegal a conspiracy to fix railroad rates, even though the individual tariffs submitted by each railroad involved in the conspiracy had been accepted by the Interstate Commerce Commission.[56] Here, as in that case, the underlying regulatory statutes did not authorize collusive action by members of the regulated industry. Where Congress has established a regulatory scheme that contemplates "competition and individual freedom of action" rather than "[t]he coercive and collusive influences of group action" (*id.* at 458–459), the Sherman Act requires that each party regulated retain its freedom of action in that area.

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[56] A similar principle was recognized recently in *Hughes Tool Co.* v. *Trans World Airlines*, *supra*, which upheld a claim of antitrust immunity on the basis of two specific regulatory provisions authorizing the Civil Aeronautics Board to approve the challenged transactions applying antitrust standards and immunizing such approved transactions. The Court also held, however, that those provisions did not completely displace the antitrust laws, noting specifically that a combination or agreement between two air carriers involving trade restraints would obviously be subject to the antitrust laws. 409 U.S. at 387.

CONCLUSION

For the reasons stated, the judgment of the district court dismissing the complaint should be reversed.

Respectfully submitted.

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DECEMBER 1974.

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No. 73-1701

IN THE

Supreme Court of the United States

October Term, 1974

UNITED STATES OF AMERICA,

Appellant,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR APPELLEE MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

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Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR APPELLEE MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC.

For the reasons argued in the briefs of the other defendant-appellees, Massachusetts Investors Growth Stock Fund, Inc. ("MIGS") urges the Court to affirm the judgment of dismissal entered by the United States District Court. MIGS also notes that, as demonstrated in its motion papers below, it is not even a party to contracts containing the types of restriction alleged by the Department of Justice in paragraph 41 of its complaint and that this factor alone would provide basis for dismissal of the complaint as to MIGS.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR APPELLEES WELLINGTON MANAGEMENT COMPANY AND WELLINGTON FUND, INC.

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF OF APPELLEES WELLINGTON MANAGEMENT COMPANY AND WELLINGTON FUND, INC.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, ("Investment Company Act") are set forth in the Statutory Appendix hereto.

QUESTIONS PRESENTED

1. Was the District Court correct in ruling that the "pervasive regulatory scheme of § 22 of the Investment Company Act" pre-empted the antitrust laws and gave the SEC exclusive jurisdiction in the "narrow area of distribution and sale of mutual fund shares"?

2. Was the District Court correct in ruling that the retail price maintenance provisions of § 22(d) and its "necessary companion," § 22(f), authorizing restrictions on transferability

of mutual fund shares, specifically exempt the alleged unlawful activities from normal antitrust strictures?

COUNTER STATEMENT OF THE CASE

The Antitrust Division of the Department of Justice ("Appellant") seeks in this direct appeal to overturn the decision of the District Court for the District of Columbia, dismissing with prejudice an action instituted pursuant to § 4 of the Sherman Act, 15 U.S.C. § 4. Wellington Fund, Inc. ("Wellington Fund") and Wellington Management Company ("Wellington") are Defendant-Appellees herein and submit this brief in support of the District Court's decision.

Wellington Fund is an open-end investment company, commonly called a "mutual fund," and is regulated by the Securities and Exchange Commission under the Investment Company Act. Wellington is the principal underwriter of shares issued by Wellington Fund. Wellington is regulated by the SEC as a broker-dealer under the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a, *et seq.*, ("Exchange Act") and as an investment adviser under the Investment Advisers Act of 1940, as amended, 15 U.S.C. § 80b-1, *et seq*.

The other Defendant-Appellees include seven securities dealers which sell mutual fund shares to the investing public and the National Association of Securities Dealers, Inc., ("NASD"). The NASD is the only national securities association registered with the SEC under the "Maloney Act" (§ 15A of the Exchange Act, 15 U.S.C. § 78*o*-3). The NASD, subject to SEC oversight, exercises industry self-regulatory functions with respect to the distribution of mutual fund shares and other transactions in the over-the-counter securities markets. Wellington, as well as all brokers and dealers registered under the Exchange Act, is required by § 15(b)(8) of that Act, 15 U.S.C. § 78*o*(b)(8), to be either a member of the NASD or to submit to equivalent regulation directly by the SEC.

THE COMPLAINT

The Complaint[1] alleged that the Appellees, in violation of § 1 of the Sherman Act, entered into a conspiracy in restraint of trade, designed to prevent the development of a "secondary dealer market" and a "brokerage market" in the purchase and sale of mutual fund shares. The Complaint specifically alleged that various rules of the NASD, as well as other NASD activities, constituted an integral part of the alleged conspiracy.

Appellant now states that it "is not challenging the validity of the NASD rules themselves" (App. Br. at 51, n. 47). Hence, apart from the horizontal allegations of Count I, Appellant has left only the allegations of the Complaint which relate to certain contracts among principal underwriters, mutual funds and broker-dealers ("sales agreements"). The sales agreements allegedly contain provisions which, *inter alia,* obligate the principal underwriters and retail dealers in fund shares either to act as principals or, if acting as agents, to maintain the public offering price described in the funds' prospectuses. They allegedly also prohibit retail dealers from (1) buying shares for resale to customers from persons other than the funds or the principal underwriters; and from (2) selling shares purchased from customers to persons other than the funds or their principal underwriters (Compl. Counts II-VIII).

The Complaint was filed after institution of a private treble damage class action, based upon substantially similar allegations, against many of the same defendants (*Haddad* v. *Crosby Corp.,*

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[1]References to "the Complaint" or "Compl." are to Appellant's Complaint filed in the District Court for the District of Columbia in Civil Action No. 338-73; references to "App. Br." are to Appellant's Brief on the Merits submitted to this Court; references to "J.S." are to Appellant's Jurisdictional Statement. References to "J.S. App." refer to the opinion of the District Court as printed in the Appendix to the Jurisdictional Statement. References to "Joint Appendix" are to the Joint Appendix filed by Appellant and Appellees in this case. Except where otherwise noted, emphasis in quotations has been supplied throughout this Brief.

Civ. No. 2454-72 (D.D.C. December 8, 1972)). Subsequent to the filing of the Complaint, forty-two additional private treble damage class actions were filed. The Judicial Panel on Multidistrict Litigation ordered all of the private class actions transferred to and consolidated in the District Court for the District of Columbia.

THE DISTRIBUTION OF MUTUAL FUND SHARES

The Complaint attacks the activities of Appellees in the distribution of mutual fund shares. The system for such distribution reflects the unique characteristics of mutual funds which continuously offer their shares for sale to the public and which, as required by law, allow investors continuously to redeem fund shares at net asset value. Depending on the mutual fund involved, a sales charge or "load" may be imposed by the fund on sales of its shares.

The unique characteristics of mutual funds have been recognized by this Court in *United States* v. *Cartwright*, 411 U.S. 546 (1973). The Court there observed:

> "Unquestionably, the most unique characteristic of mutual funds is that they are permitted, under the [Investment Company] Act to market their shares continuously to the public, but are required to be prepared to redeem outstanding shares at any time. § 80a-22(e)." 411 U.S. at 547.

The continuous obligation of redemption and the offering of fund shares are closely interrelated. Since mutual funds must continuously redeem outstanding shares, they can avoid self-liquidation only if they can continuously offer new shares. This interdependence was recognized by the District Court:

> "To insure that the fund has sufficient cash or liquid assets on hand to meet current redemptions, the fund offers its common stock continuously. . . . The viability

> of a fund thus depends upon a distribution system which will effect continuous sales at prices which will support current redemption demands." J.S. App. at 42, 43.

To sell continuously to the public, mutual funds, such as Wellington Fund, typically enter into exclusive distribution contracts with underwriters, such as Wellington. The underwriters in turn establish continuous distribution channels by entering into agreements with numerous securities dealers. The dealers then sell the funds' shares to the public and accept them from the public for redemption by the funds. Most dealers enter into sales agreements with many principal underwriters and sell shares of many different funds to the public. This is the primary distribution system. As recognized by this Court in *Cartwright*, for all practical purposes it is the "only market" for mutual fund shares. 411 U.S. at 551.

REGULATION OF THE DISTRIBUTION SYSTEM

The Investment Company Act also recognized the importance of continuous redemption and distribution and established elaborate regulatory mechanisms governing both of these unique characteristics of mutual funds. Thus, § 22(e) of the Act expressly codifies and subjects to SEC regulation the right of mutual fund shareholders to redeem fund shares on demand. It prohibits a mutual fund from suspending the right of redemption, or from postponing payment upon redemption, during unrestricted trading periods on the New York Stock Exchange, for more than seven days after tender, except under very limited conditions as determined by the SEC.

The Act also regulates the primary distribution system, including the relationships between principal underwriters and investment companies in that system. Section 12(b) expresses a preference that load mutual funds distribute their shares through principal underwriters. Sections 15(b) and (c) require

the principal underwriter to act for the fund pursuant to a written contract. The contract must contain specific provisions prescribed by the Act. It must also be approved by the fund's shareholders or by the fund's board of directors which must meet the criteria for independence contained in § 10(b)(2) of the Act.

The provisions of the Act also reflect a Congressional determination to protect the primary distribution system from secondary market competition. As the Commission reported in 1972:

> "Elimination of that market was considered to be a major motivation behind the enactment of Section 22(d)."[2]

Section 22(d) accomplishes this objective by imposing what Appellant has characterized as a "rigid scheme of price maintenance at the retail level."[3] It expressly requires that:

> "if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus."

Section 22(d) is not limited to the primary distribution system. It requires all "dealers", whether they operate in the primary system under contract with the principal underwriter or in the secondary market, to sell mutual fund shares at the price fixed

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[2]*Report of the Staff of the SEC on the Potential Economic Impact of a Repeal of § 22(d) of the Investment Company Act of 1940,* November, 1972, Pt. II, at 292. (Hereinafter referred to as "1972 SEC Staff § 22(d) Report").

[3]*Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings,* SEC File No. 4-164, Feb. 2, 1973 at 3.

in the prospectus. As stated by former SEC Chairman Manuel F. Cohen in testimony before Congress:

> "The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer."[4]

In § 22(f) of the Act, Congress preserved for mutual funds an additional means of protection against the secondary market. That section recognized the right of mutual funds, subject to disclosure and SEC regulation, to impose restrictions on the transferability of their shares. Such restrictions, prior to enactment of the Investment Company Act, had been used by the funds to protect the primary distribution system against the secondary market by issuing certificates which provided "substantially that the shares could only be sold or tendered for redemption to the open-end investment company."[5]

Sections 22(d) and 22(f) have substantially achieved their purpose. The Commission has estimated that in the pre-1940 mutual fund industry the secondary market dollar volume of shares sold was equal to the volume of sales through the primary distribution system. (Investment Trust Study at 809). In contrast, as the SEC has found, secondary market volume in 1971 was "miniscule". (1972 SEC Staff § 22(d) Report at A-113).[6]

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[4]*Hearings on H. R.* 9510 *and H. R.* 9511 *Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce,* 90th Cong., 1st Sess. 711 (1967). (Hereinafter referred to as "1967 House Hearings").

[5]*SEC Report on the Study of Investment Trusts and Investment Companies,* Pt. Three, House Doc. No. 279, 76th Cong., 1st Sess. 865 (1939-40). (Hereinafter referred to as "Investment Trust Study").

[6]The secondary market in mutual fund shares both before and after 1940 was a dealer market. Appellant has not claimed that there ever was a brokerage market in fund shares as described in its Complaint.

Congress balanced its proscription against retail price competition with regulatory protections against "excessive" sales charges and unfair dilution of investor interests. Section 22(a) of the Act empowers the NASD to adopt rules prescribing methods for computing minimum sales and redemption prices designed to reduce and, insofar as possible, to eliminate unfair dilution of the interests of fund shareholders. Section 22(b), as amended in 1970, not only authorizes but directs the NASD, under SEC oversight, to prescribe rules prohibiting "excessive" sales charges.[7] Pursuant to this Congressional directive, the Commission recently allowed the NASD to adopt proposed rules setting sales load limits on mutual fund shares.[8]

THE DECISION BELOW

In dismissing Appellant's Complaint, the District Court emphasized the critical importance of the primary distribution system and the policy of Congress to reject "all attempts to foster a secondary market which might operate to the detriment of the primary market." (J.S. App. at 47). After reviewing the legislative history and the SEC's interpretation of § 22(d) and § 22(f), the court held that each of those sections specifically exempted Appellees' sales agreements from the antitrust laws. The court said:

> "It is thus apparent that Congress designed §§ 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is 'incompatible with the maintenance of (an) antitrust action.'" J.S. App. at 58 (Citations omitted).

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[7]Prior to the 1970 amendments, § 22(b) authorized the NASD to adopt rules prohibiting "grossly excessive" sales charges.

[8]Investment Company Act Release No. 8570 (Nov. 4, 1974), CCH Fed. Sec. L. Rep. ¶ 79,998 (1974).

The District Court went on to rule that, even if no specific exemptions existed, the pervasive system of regulation of the distribution of mutual fund shares imposed by the Investment Company Act and the Maloney Act placed responsibility for regulating "this complex field" within the exclusive jurisdiction of the SEC. The court stated:

> "The language of both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency." *Id.* at 62, 63.

Accordingly, the court ruled that the two acts gave rise to a "narrow," implied exemption from the antitrust laws. The court held:

> "[G]iven the fact that Congress clearly intended to substitute a pervasive regulatory scheme, i.e. § 22 of the [Investment Company] Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is clear that the price maintenance practices complained of are immune from ordinary antitrust strictures." *Id.* at 67.

In so ruling the court below found that "[s]ince 1940, the SEC has actively regulated the pricing and distribution of mutual fund shares" (*Id.* at 39), that § 22(d) "has been reconsidered by Congress several times", and that despite the urging of Appellant, Congress has "consistently refused to modify or repeal it. . . ." (*Id.* at 51). The court pointed out:

> "Whether the mutual fund marketing structure mandated by Congress in 1940 should be eliminated or modified is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide. In fact, in urging its complaint upon the Court, one of the plaintiffs, *viz.*, the

Department of Justice, seeks to accomplish indirectly what it has failed, so far, to achieve directly—the repeal or modification of § 22(d)—in hearings before both Congress and the SEC." *Id.* at 58.[9]

THE 1974 SEC § 22(d) REPORT

On November 4, 1974, SEC Chairman Garrett transmitted to Congress a report on "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940." ("1974 SEC § 22(d) Report" or "Report").[10] At the same time, the Commission announced its program to revise its administration of, and to seek legislative changes in the laws affecting, mutual fund distribution.[11]

The Commission's program constitutes a multifaceted plan for a gradual restructuring of the mutual fund distribution system. Some restructuring was found desirable by the Commission because of the "new and serious difficulties" which now beset the mutual fund industry. (Transmittal Letter at iii). The Commission noted that "the operation of the regulatory system" restricted the ability of the industry to adjust to changed conditions and that:

> "Meanwhile, changes in brokerage allocation practices of mutual funds, the reduction in mutual fund brokerage resulting from the onset of fully competitive stock exchange rates, and competition from other financial products which can be more easily sold on the basis of current yield (and which also offer attractive incentives to salesmen); make it increasingly difficult for mutual funds to

[9]See, e.g., *1967 House Hearings;* and *Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings, supra,* n. 3.

[10]CCH Mutual Funds Guide, (Part II) Nov. 8, 1974. References to the Report itself are cited as "1974 SEC § 22(d) Report at "; references to Chairman Garrett's letter transmitting the 1974 SEC § 22(d) Report to Congress are cited as "Transmittal Letter at ."

[11]Investment Company Act Rel. No. 8570 (Nov. 4, 1974), CCH Fed. Sec. Rep. ¶ 79,998.

> compete successfully for the salesman's favor, even while they are hampered in developing market demand among investors." *Id.* at iv.

In light of these changed conditions, the Commission's program is designed to:

> "[L]ay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system." *Id.* at v.

The SEC's program, when implemented, would effect many of Appellant's desired changes in mutual fund distribution. Indeed, the Report specifically concluded that the sales agreements which are the subject of this case should be modified—either voluntarily or by a rule promulgated pursuant to § 22(f)—to allow the establishment of a "limited secondary brokered market" in mutual fund shares. However, contrary to the result being sought by the Appellant, the Report does not recommend the immediate elimination of restraints on a secondary dealer market. Rather, the Report states that the operation of the "brokered" market would provide the SEC with "important insight into whether a secondary *dealer* market could function effectively." (1974 SEC § 22(d) Report at 105) [Emphasis in the original].

The development of the brokered market recommended by the Report would occur "in the context of the Commission's total regulatory scheme respecting fund distribution." The Commission recognized that development of a secondary brokerage market requires other regulatory changes "designed to encourage economies and efficiencies in the present fund distribution system and ultimately to move the industry into a position where it could function effectively in an environment of full retail price competition." Such changes include, but are not limited to, liberalization of mutual fund advertising rules,[12] expanded group

[12] 1974 SEC § 22(d) Report at 84.

sales[13] and so-called "open seasons."[14] These changes, moreover, will be conditioned by provisions designed "to help neutralize any adverse impact upon the funds' primary distribution system. . . ." The conditions include:

Transfer Fees For Brokered Transactions[15]

To ensure that the underwriter is adequately compensated for its advertising and distribution efforts, the Commission will allow a reasonable transfer fee on brokered transactions. Such a fee would be collected by the fund when ownership of its shares is transferred and would, of course, aid in protecting the primary distribution system and ensuring that the fair allocation of continuing costs are borne by all fund shareholders.

Anti-Warehousing Provisions[16]

The Commission also proposed to prohibit brokered orders from being held for more than one full business day, thereby preventing excessive delay in execution of customers' orders.

Special Exemptive Orders[17]

The Commission made it clear that whenever a fund demonstrates that its primary distribution system is being injured by the secondary brokered market, it will consider issuance of an exemptive order under § 22(f) to allow reimposition of the contractual restrictions complained of by Appellant.

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[13] *Id.* at 89.
[14] *Id.* at 93, 94.
[15] *Id.* at 105, 106.
[16] *Id.* at 107.
[17] *Id.* at 108.

All of these changes, those designed to encourage competition, those designed to protect the primary distribution system, and those otherwise designed to protect investors, were proposed in light of the Commission's understanding of that system and of the drastic consequences of its forced and sudden abandonment. As the Commission concluded:

> "[I]t would be unrealistic to suppose that a sudden end to retail price maintenance would be accompanied by the level of investor sophistication and sensitivity to sales loads that would be needed to make a price competitive distribution system work. The more likely result of a precipitous end to retail price maintenance would be an end to widespread distribution of mutual fund shares, and most Americans would not have an opportunity to consider investing in mutual funds. As a consequence, many mutual funds—which by their nature tend to be self-liquidating and, therefore, require continuous distribution—would be adversely affected." Transmittal Letter at v.

SUMMARY OF ARGUMENT

The Investment Company Act of 1940 was enacted in response to the problems found to exist in the mutual fund industry at that time. The Act was tailored to deal with those problems in the context of the unique characteristics of mutual funds, i.e. the continuous need to distribute new shares to offset the threat of self-liquidation caused by the continuous obligation to redeem outstanding shares. The ability to maintain continuous distribution was adversely affected by the so-called "bootleg" market in mutual fund shares. Operations of the "bootleg", or secondary, market tended to channel mutual fund sales out of the primary distribution system, raising the threat of self-liquidation. (Investment Trust Study at 809, 865).

Congress responded to that danger by enacting § 22 of the Investment Company Act, which regulated every aspect of the distribution system. For over 30 years, Congress, the SEC, and participants in the mutual fund industry have recognized that § 22, and particularly § 22(d), represented a Congressional abandonment of normal antitrust considerations in favor of a rigid, involuntary scheme of retail price maintenance designed to protect the primary distribution system. The system of retail price maintenance was re-enacted without change in 1970.

The pervasive regulatory scheme embodied in § 22 authorizes the SEC, either on its own or through its authority to oversee the NASD, to regulate the distribution system in accordance with Congressional policy. The SEC has continually exercised that authority and has only recently proposed a restructuring of the mutual fund distribution system. The relief sought by Appellant in this case is inconsistent with the SEC proposal. In fact, granting such relief would unquestionably cause "two regimes to collide." (*Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296 (1963)).

In light of the authority granted the SEC pursuant to a Congressional decision to abandon normal competitive requirements, the SEC exercise of that authority, the SEC's expertise in this highly complex area, and the certainty of conflict should the antitrust court intrude, the decision of the court below that "the price maintenance practices complained of are immune from ordinary antitrust strictures" should be affirmed. See *Pan American, supra; Hughes Tool Company* v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973); *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); and *Gordon* v. *New York Stock Exchange*, 498 F.2d 1303 (2d Cir. 1974), *cert. granted*, 43 U.S.L.W. 3295 (1974).

The court below also was correct in holding that both the retail price maintenance provisions of § 22(d) and its necessary companion, § 22(f), specifically exempt the activities complained

of from the antitrust laws. A principal purpose of § 22(d) was to protect the primary distribution system from disruptive secondary market competition. It accomplished that purpose by requiring all "dealers"—i.e. persons "regularly engaged in the business" of buying and selling securities for their own account—to comply with § 22(d) and maintain the public offering price in sales of mutual fund shares. This provision eliminated the ability of the secondary market to engage in the cutthroat price competition which jeopardized the primary distribution system prior to 1940, and had the effect of channeling all mutual fund share sales and redemptions into the primary distribution system. Section 22(f), which sanctions restrictions on transferability, was specifically designed to allow continuation of the practice of restricting transferability of fund shares in order to keep sales and redemption of such shares in the primary distribution system.

Appellant's attempt to limit the scope of § 22(d) and § 22(f) to the primary distribution system must be rejected. The result sought by Appellant can be reached only through a completely unjustified, narrow reading of the language of both § 22(d) and § 22(f). It is directly contrary to the Congressional determination that protection of investors in mutual fund shares is best served by preserving the integrity of the primary distribution system at the expense of normal competitive requirements.

ARGUMENT

I.

THE DISTRICT COURT CORRECTLY RULED THAT THE PERVASIVE REGULATORY SCHEME OF THE INVESTMENT COMPANY ACT IMPLIEDLY EXEMPTS THE DISTRIBUTION OF MUTUAL FUND SHARES FROM THE ANTITRUST LAWS AND GRANTS TO THE SEC EXCLUSIVE JURISDICTION OVER THE ALLEGED UNLAWFUL CONDUCT OF APPELLEES.

A. Appellant Misconceives the Standards For Establishing Implied Immunity From The Antitrust Laws

The court below recognized that the antitrust laws are applied to regulated industries with the understanding that Congress, in establishing regulatory patterns, responds to specific problems existing within a particular industry, and that when Congress applies regulatory considerations to those problems it may reject competition in favor of regulation. In this case, Congress, in enacting the Investment Company Act, responded to the specific problem of disruptive secondary market competition with the primary distribution system for mutual fund shares. Such competition was deemed a threat to the industry, which was especially dependent on a strong primary distribution system for new fund shares in order to meet its obligation to redeem outstanding shares without being threatened by self-liquidation. Congress responded by establishing a regulated retail price maintenance system designed to restrict normal competitive influences. In so doing, it impliedly immunized the activities of that distribution system from the antitrust laws and entrusted the governing of those activities to the exclusive jurisdiction of SEC regulation.

This conclusion flows from the type of analysis that this Court traditionally makes in determining whether antitrust immunity is to be inferred from the pattern of industry regulation adopted by the Congress. This analysis consists of three separate

steps. The first step is to determine the Congressional purpose in enacting the regulatory scheme, for it is the duty of the courts to give "hospitable scope" to that purpose. *United States* v. *Hutcheson*, 312 U.S. 219, 235 (1941). Almost every case involving implied immunity deals with that issue. See *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726 (1973); *Hughes Tool Company* v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973) and *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296 (1963).

If it is determined that Congress intended to substitute regulation for competition or to subject normal competitive forces to specific regulatory restrictions, then the scope of that regulatory power must be examined to determine whether a regulatory agency has authority to deal with the activities complained of. See *Hughes, supra*, and *Pan American, supra*. Finally, if the agency has authority to deal with the matter, the antitrust court must determine whether its intervention would create the possibility of conflict with the regulatory agency and undermine the regulatory pattern established by the Congress. See *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963) and *Gordon* v. *New York Stock Exchange*, 498 F.2d 1303 (2d Cir. 1974) *cert. granted* 43 U.S.L.W. 3295 (1974).

Appellant ignores this analysis. Indeed, it does not concede that implied immunity from the antitrust laws is necessarily found when application of those laws to the conduct challenged would create a "basic conflict with the authority of the regulatory agency." (App. Br. at 56). It argues that even where conflict actually exists, implied immunity may be found only if three additional conditions exist. Appellant characterizes these conditions as:

> "(1) the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers; (2) the regulatory scheme must require the supervising agency to focus

upon competitive considerations in exercising those powers; and (3) the agency must have express statutory authority to immunize the conduct in question from the antitrust laws." App. Br. at 56.

Appellant does not cite any case to support its contention that any one, much less all three, of these conditions, are essential prerequisites for implied immunity. Indeed, no such case exists. Appellant's argument reflects fundamental misconceptions of the way this Court has applied the antitrust laws to regulated industries.

1. Appellant's First Misconception

Appellant's argument that to find antitrust immunity "the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers" mistakes the facts in one case for the rule to be applied in all cases. For example, in *Hughes, supra,* cited by Appellant, (App. Br. at 56), the issue being litigated—the way in which Toolco had exercised its control over TWA—was in fact the subject of a CAB proceeding, and this Court ruled that an implied immunity did exist. However, this Court did not rule that such a proceeding was a *condition* to finding an implied immunity. On the contrary, the Court ruled:

> "[T]he authority of the Board to grant the power to 'control' and to investigate and alter the manner in which that 'control' is exercised leads us to conclude that this phase of CAB jurisdiction, like the one in the *Pan American* case, pre-empts the antitrust field." 409 U.S. at 385.

Indeed, the Court in *Hughes,* stated that in *Pan American Airways, Inc.* v. *United States* no such proceeding occurred.

> "It should be noted in that connection that in the *Pan American* case, Pan American, which owned 50%

of the stock of the air carrier Panagra, was charged with using its control to prevent Panagra from receiving the authority of the CAB to extend its route from the Canal Zone to the United States. That restraint was held beyond the reach of the antitrust laws *even though the CAB had taken no action to investigate, let alone, act* on the alleged misfeasance. . . ." 409 U.S. at 385, 386.

The pertinent inquiry, then, is not as to the existence of a "proceeding" but as to *authority*. If action has been taken pursuant to that authority, as in the instant case, the existence of an implied immunity is even clearer.

Clearly, if a regulatory agency lacks authority over a specific practice, it would be impossible to conclude that the antitrust laws were preempted with respect to that practice. Thus, in *Silver, supra*, this Court held that the SEC had no jurisdiction over the allegedly unlawful activities of the Exchange, and therefore normal antitrust strictures were applicable. The opinion in *Silver* suggested, however, that "a different case" would arise if the SEC did have jurisdiction over those activities. (373 U.S. at 358 n, 12).

In *Gordon, supra*, the Court of Appeals for the Second Circuit found the "different case" contemplated by *Silver*. (498 F.2d at 1304). The court held that the SEC had exclusive jurisdiction over the New York Stock Exchange's minimum commission rate structure because the Commission had authority over that structure, i.e. the power to alter or supplement Exchange rules, and was exercising that authority. Here the case is stronger. The Commission has the authority over the practices complained of, is exercising that authority, and in addition, unlike *Gordon*, must act pursuant to a direct statement of Congressional policy drastically limiting competition in the distribution of mutual fund shares through a system of retail price maintenance.

2. Appellant's Second Misconception

Appellant further argues that to find an implied immunity the "regulatory scheme must require the supervising agency to focus upon competitive considerations in exercising those powers." (App. Br. at 56). Appellant ignores, however, the obvious fact that competition is *not* always the Congressional goal in formulating regulatory legislation. In some instances Congress abandons competition for other goals. Thus, a determination of whether a pervasive regulatory scheme implies a limited antitrust immunity depends on whether Congress has favored regulation over competition in the area in question.

The court below recognized that in this case competition was abandoned in favor of another regulatory goal. That goal was protection of the primary distribution system from secondary market competition. Protection was accorded to that system by Congress because it believed that, given the obligation to redeem, continuous sales of new fund shares were essential to the preservation of the mutual fund industry. The importance of protecting that primary system from unfair and destructive secondary market competition is still recognized by the SEC[18] and accordingly, competitive considerations remain subservient to the principal regulatory concerns of the agency.

In bringing this case the Antitrust Division would have served the public interest better had it heeded the admonition of the District of Columbia Circuit Court of Appeals to the FCC in *Hawaiian Telephone Co.* v. *Federal Communications Commission*, 498 F.2d 771 (D. C. Cir. 1974). In that case the court held that the FCC improperly considered competition when it approved telephone service between Hawaii and the mainland. The court stated:

> "The whole theory of licensing and regulation by government agencies is based on the belief that competition

[18]1974 SEC § 22(d) Report at 105.

cannot be trusted to do the job of regulation in that particular industry which competition does in other sectors of the economy. Without in any way derogating the merits of the competitive free enterprise system in the economy as a whole, we cannot accept the action of the FCC here in a tightly regulated industry, supported by an opinion which does no more than automatically equate the public interest with additional competition." (*Id.* at 777).

3. Appellant's Third Misconception

Finally, Appellant argues that to find exclusive jurisdiction the administrative agency must have express statutory authority to immunize the conduct challenged from the antitrust laws. Appellant cites *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963), *Hughes, supra, Pan American, supra,* and *Silver supra,* apparently for this proposition. None of those cases, upon examination, supports that contention. In *Silver,* this Court ruled that the SEC lacked authority over enforcement of the Exchange rules being challenged. In the absence of such authority there could be no immunity, and there was no need to consider whether the SEC's jurisdiction was exclusive. Thus, that case did not turn on the absence of express immunizing power but on the absence of any jurisdiction.

The *Hughes* and *Pan American* cases involved the Federal Aviation Act, which does provide that when certain agreements between carriers are approved by the CAB antitrust immunity attaches. However, the decisions in those cases, finding immunity, did not turn on that point. Rather, they turned on the existence of the authority in the CAB to review the alleged unlawful acts in the context of a regulatory policy that overlapped and conflicted with normal antitrust considerations. The existence of such authority convinced this Court that to impose antitrust strictures on parties subject to the CAB jurisdiction

would result in an intrusion upon and a frustration of the authority of the CAB.

Appellant also misreads this Court's decision in *Philadelphia National Bank*. In that case, the Bank Merger Act did not confer immunizing authority on the Comptroller of the Currency. But this Court's decision that there was no immunity turned not on the absence of such authority, but on a finding that the Federal regulatory pattern over the banking industry reflected a Congressional intent not to preempt the antitrust laws. In fact, the legislative history made clear that Congress intended that no immunity be implied. The Court stated:

> "Nor did Congress, in passing the Bank Merger Act, embrace the view that federal regulation of banking is so comprehensive that enforcement of the antitrust laws would be either unnecessary, in light of the completeness of the regulatory structure, *or disruptive of that structure*. On the contrary, the legislative history of the Act seems clearly to refute any suggestion that applicability of the antitrust laws was to be affected. *Both the House and Senate Committee Reports stated that the Act would not affect in any way the applicability of the antitrust laws to bank acquisitions*." 374 U.S. at 352.

In each of the cases relied upon by Appellant, this Court's rationale is clear. Antitrust immunity turns upon the existence of administrative authority to deal with the conduct complained of and upon evidence that Congress intended that the administrative authority displace the antitrust courts in dealing with that conduct. Immunity was denied where the administrative authority did not exist, as in *Silver*, and where the authority that was conferred upon the agency was not intended to displace antitrust policy, as in *Philadelphia National Bank*. Immunity was granted where both authority and intent to displace were found, as in *Pan American* and *Hughes*.

This Court's rationale in the cases discussed above has been followed recently by the Court of Appeals for the Second Circuit. In *Gordon* v. *New York Stock Exchange, supra,* at 14, that court distinguished *Silver,* and held that the language and legislative history of § 19(b) (9) of the Exchange Act, giving the SEC power to alter or supplement Exchange rules over the fixing of commission rates, and the sound policy considerations governing securities regulation, demand the conclusion that such authority exempts the fixing of commission rates from the antitrust laws. That case did not turn on the existence of specific immunizing authority. Indeed none existed. Moreover, unlike this case there was no statutory pattern like § 22 which expressed a Congressional policy to directly regulate an entire aspect of industry operations—i.e. distribution of mutual fund shares—in a manner completely repugnant to the antitrust laws. Nevertheless, the court found that the potential for conflict between the pervasive regulatory pattern administered by the SEC and antitrust policy enforced by the courts represented persuasive evidence of a Congressional intent to displace the antitrust laws.

The same result as in *Gordon* has been reached by the only other two lower court cases which have considered whether alleged illegal acts in the pricing of mutual fund shares are exempt from the antitrust laws. In each case the court reached an affirmative decision although express immunizing authority was lacking. Those cases are the decision of the District Court below and *Baum* v. *Investors Diversified Services,* 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd,* 409 F.2d 872 (7th Cir. 1969).

Thus, in no case, including the cases cited by Appellant, has this Court or any other court established a rule requiring the existence of an express statutory immunizing authority as a condition to finding implied immunity. To the contrary, the issue of implied immunity turns on an overall evaluation of the Congressional objectives in fashioning the particular regulatory scheme involved. As suggested by this Court in *Philadelphia*

National Bank, a Congressional objective to pre-empt the antitrust laws can be evidenced by a regulatory scheme so complete as to leave no area untouched by the regulatory process in which the antitrust laws could operate, or by a regulatory scheme structured in such a way that imposition of the antitrust laws would be disruptive of that structure. (*Supra* at 22.) In this case, as in *Pan Am*, *Hughes* and *Gordon*, both conditions are met.

B. Contrary to Appellant's Contention, Congress Clearly Intended to Substitute a Pervasive Regulatory System for the Antitrust Laws in the Limited Area of Mutual Fund Distribution

The court below held that Congress intended to substitute the pervasive regulatory scheme contained in § 22 of the Investment Company Act for normal antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares. In so doing, the court held, Congress immunized the price maintenance practices complained of by Appellant from ordinary antitrust strictures.

In reaching this conclusion the court below was, and this Court in reviewing that decision must be, concerned with one preeminent and overriding issue: what was Congress' purpose in establishing the system that now regulates the distribution of mutual fund shares? That question must be answered, for Congress sets this nation's policy, and it is the duty of the courts to implement that policy even though it may displace the policy in favor of competition decreed in the Sherman Act.

An understanding of Congressional purpose can be obtained by asking the following questions: what problems was Congress seeking to rectify by establishing the regulatory system? In this regard the pre-1940 mechanism by which mutual fund shares were distributed and the problems raised by that mechanism and

recognized by Congress are crucial. How did the SEC, the agency charged with administering the legislative system, perceive its mandate from Congress, and how has it implemented that mandate through the years? Finally, and particularly important in this case, what has Congress perceived in the years subsequent to 1940 as the result of its actions, and what has been its response?

Any objective analysis of the answers to these questions will reveal that *in enacting § 22 of the Investment Company Act, the principal and overriding Congressional purpose was to protect and preserve the viability of the primary distribution system while protecting investors against excessive sales charges through regulatory rather than competitive means.*

1. Appellant Ignores the Clear Congressional Intent To Substitute Regulation For Retail Price Competition In The Distribution Of Mutual Fund Shares

Far from being a "less intrusive scheme more in keeping with free market traditions," as Appellant erroneously asserts, (App. Br. at 55), the Investment Company Act established a policy of pervasive Federal regulation for mutual fund shares. It thus represented a far-reaching departure from "free market traditions." This departure is particularly evident in § 22 of the Act which establishes a retail price maintenance system and allows restrictions on the transferability of mutual fund shares. Both are repugnant to the antitrust laws. As stated by the District Court, in its opinion below:

> "It is obvious from the foregoing outline of marketing procedures that the sale and distribution of mutual fund shares is accomplished through a *retail price maintenance system which is patently repugnant to the free and open competition requirements of the Sherman Act*. This price maintenance scheme, however, does not operate in a

vacuum. Rather, it is expressly immunized from the otherwise applicable antitrust laws by virtue of the provisions of the [Investment Company] Act and the Maloney Act." J.S. App. at 43, 44.

The anticompetitive nature of the regulatory system governing mutual fund distribution has been repeatedly recognized. The former Chairman of the SEC has, in urging Congress to strengthen the power of the Commission and the NASD to prohibit "excessive" sales charges, described the non-competitive nature of mutual fund distribution as follows:

> "Mutual fund sales charges are not determined by normal interplay of free market forces. . . ."
>
> * * *
>
> "Sellers of mutual fund securities have been insulated by Federal law from price competition at the retail level since 1940."[19]

Similarly, Appellant itself has described § 22(d) as "requiring a rigid scheme of price maintenance at the retail level,"[20] and the SEC, in its 1966 study on the mutual fund industry, has reported to Congress:

> "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing."[21]

The decision by Congress in 1940 to govern the mutual fund distribution system by regulation, not by unbridled price compe-

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[19] *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess. 25, 26 (1967). (Hereinafter referred to as "1967 Senate Hearings").

[20] *Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings,* SEC File No. 4-164, Feb. 2, 1973 at 3.

[21] *SEC Report on the Public Policy Implications of Investment Company Growth,* H. R. Rep. No. 2337, 89th Cong., 2d Sess. 218 (1966).

tition, is further evidenced by the restrictions on transferability permitted by § 22(f). That section, as the court below found, is "a necessary companion to" the retail price maintenance provision of § 22(d). (J.S. App. at 56). The SEC has made clear that § 22(f) gives it authority to prohibit the restrictions imposed by the sales agreements complained of by the Appellant and that it intends to use that authority to the fullest extent necessary. (1974 SEC § 22(d) Report).

2. A Principal Purpose of the Regulatory System Is To Protect the Primary Distribution System From Disruption By Secondary Markets

The court below recognized that when Congress enacted § 22 of the Act, it intended to protect the primary distribution system against destructive competition from the secondary markets. The court pointed out that:

> "*It is an economic fact, recognized by Congress, that the two markets — the primary market . . . and a secondary market as urged by the plaintiffs — cannot co-exist and both remain viable*. Having established a resale price maintenance system in the primary distribution system in which ordinary competitive influences cannot operate, Congress has rejected all attempts to foster a secondary market which might operate to the detriment of the primary market." J.S. App. at 46, 47.

This conclusion is supported both by the legislative history of the Act and the language and structure of § 22. The Commission's Investment Trust Study, which prompted enactment of the Investment Company Act, recognized that all of the distinguishing features of open-end investment companies — including the problems and distortions which plagued them — "spring from the distribution and repurchase practices" of these companies. (Investment Trust Study at 799). It noted that "possible liquidation" was a "constant threat" which required mutual funds

to maintain continuous sales programs in order to offset redemptions with new sales. (*Id.* at 807).

Accordingly the Investment Trust Study was specifically concerned with the problems connected with the distribution of mutual fund shares. (See especially, Investment Trust Study, Pt. Three, Chap. III). The Study found that prior to 1940 the public acquired fund shares through a primary distribution system much like the current system. (*Id.* at 809). The pre-1940 primary distribution system, however, was shaped not by federal regulation but by private contracts which fixed the relationships between underwriters and dealers and established sales charges for fund shares. (*Id.* at 809).

In addition to the primary distribution system, the Investment Trust Study described a secondary market in fund shares. It referred to this market as:

> "[t]he whole field of trading in shares of open-end investment companies by dealers and others. Although no definite data are available, it is known, however, that there were active over-the-counter markets for these shares. . . ." *Id.* at 809.

The Study estimated that the dollar volume of such secondary market activity was equal to the total dollar value of shares sold by investment companies through the primary distribution system. (*Ibid*).

The Study referred to the characterization of the secondary market as a "bootleg market" and described it as follows:

> "The so-called 'bootleg market' was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors for those companies. These dealers would often offer a little more than the published redemption price and ask a little less than the published sales price. In an

> active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short." *Id.* at 865.

The Study concluded with respect to the "bootleg" market that "[s]uch operations *actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price." (Ibid).*

The Study also noted that there was "considerable activity by dealers in switching customers from one open-end investment company to another." (*Id.* at 809). It observed that some individual mutual funds made their own attempts to curb the activities of that "bootleg" market, pointing out that:

> "Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company." *Id.* at 865.

The Investment Trust Study had found, however, that the funds were dependent on the dealers for distribution of their shares. As a result, the dealers could take advantage of the dependence of the funds on their distribution efforts to create numerous distortion in the funds' activities. As stated in the Study:

> "[A]ny device or practice which would facilitate the task of the dealer might be adopted or encouraged by open-end investment companies in order to assure the continued sale of their securities." *Id.* at 827.

For these reasons, competitive pressures made ineffective the voluntary efforts of individual funds to deal with the abuses of the secondary market. As the Study concluded:

"The dependence of open-end investment companies upon numerous dealers for the distribution of their shares usually discouraged any effort to supervise or restrict the dealers' trading activities." *Id.* at 828.

Congress responded to the problems created by the bootleg market in the enactment of § 22. Nothing is more illustrative of this fact than the testimony of Mr. David Schenker, the Director of the Investment Trust Study and chief spokesman for the SEC during the Congressional hearings which led to the enactment of the Investment Company Act. Testifying on the genesis of § 22(f),[22] Mr. Schenker stated:

"There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. *It presents a whole problem which they call the bootleg market.* What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company. That is a big problem; but it seems to me . . . you are taking away a big portion of the owner's right of initiative."[23]

Mr. Schenker went on to say that the regulation of such restrictions on transferability "ought to be a subject of rules and regulations" (*Id.* at 292), and provoked the following exchange with Senator Wagner, the sponsor of the bill:

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[22]The predecessor of § 22(f) was § 22(d) (2) of the original bill submitted by the SEC.

[23]*Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 292 (1940). (Hereinafter referred to as "1940 Senate Hearings").

"Senator WAGNER. You provide rules?

Mr. SCHENKER. That is right.

Senator WAGNER. *You provide rules, I suppose, under which they make application to the Commission with respect to whether they may or not?*

Mr. SCHENKER. *No. If this bill becomes law, and after we study the whole situation, if we feel there are abuses which cannot be corrected except by putting in a restriction on alienability, then we shall formulate rules, after discussing them with the industry.*"[24]

Mr. Schenker's answer to Senator Wagner's last question indicates that Congress and the SEC intended to permit mutual funds to continue using the existing restrictions on transferability absent Commission rules to the contrary. This intention became clearer in the revised bill which emerged from industry–SEC negotiating sessions. Section 22(f) of the revised bill, as enacted, said:

> "No registered open-end company *shall restrict* the transferability or negotiability of any security of which it is the issuer *except in conformity with* the statements with respect thereto contained in its registration statement *nor in contravention* of such rules and regulations as the Commission *may prescribe* in the interest of the holders of all of the outstanding securities of such investment company."

The Senate Committee report on the bill also evidenced the Congressional intention to allow restrictions to be used if no SEC rules prevented them. It stated: "The negotiability of open-end securities may not be restricted in contravention of provisions which *may* be formulated. . . ."[25] The House Committee Report

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[24]1940 Senate Hearings at 293.
[25]S. Rep. No. 1775., 76th Cong., 3d Sess. 16 (1940).

is to the same effect: "Subsection (f) provides that the negotiability or transferability of redeemable securities of open-end companies may not be restricted in contravention of rules and regulations which the Commission *may* prescribe."[26] Thus, the legislative history makes it abundantly clear that Congress enacted § 22(f) with a clear knowledge of the purpose to which restrictions on transferability had been put by the funds and that Congress intended to let them stand absent SEC action to the contrary.

Appellant, understandably in light of the foregoing, has little to say concerning the legislative history of § 22(f). It takes considerable pains however, to attempt to show that the Congressional intent underlying the retail price maintenance provisions of § 22(d) has nothing to do with elimination of secondary market competition. According to Appellant, § 22(d) was merely intended to remedy the problem of "dilution" caused by "insider trading". (App. Br. at 26).

Appellant points out (App. Br. at 29, 30), in support of its argument, that the original SEC sponsored bill would have required "forward pricing" and prohibited "backward pricing" of fund shares. Such forward pricing, according to Appellant, would have eliminated the problem of "dilution" caused by "insider trading". According to Appellant, the forward pricing requirement was opposed by the industry and dropped in the compromise bill in favor of § 22(d). That section, Appellant argues, served the same anti-dilution purpose by requiring "insiders as well as all other investors to pay the full public offering price. . . ." (App. Br. at 31).

Appellant is simply wrong in its reading of the legislative history. The bill as finally enacted dealt with backward pricing as well as with other causes of unfair dilution. It did so, however, not through § 22(d) but through the provisions of §§ 22(a) and 22(c). Those sections, *inter alia*, specifically authorize the NASD (and if the NASD fails to act, the SEC) to adopt rules in

[26] H.R. Rep. No. 2639, 76th Cong., 3d Sess. 20 (1940).

connection with the sale of mutual fund shares "for the purpose of eliminating or reducing sc far as reasonably practical, *any dilution* of the value of other outstanding securities of" an investment company. In fact, the SEC has used its authority under § 22(c) to eliminate the very practice of backward pricing by establishing a forward pricing rule. (Investment Company Act Rule 22c-1, 17 C.F.R. § 270.22c-1).

The SEC's forward pricing rule was not adopted until 1968. However, soon after passage of the Act in 1940, the SEC was granting exemptions from § 22(d) to allow *insiders* to purchase mutual fund shares at no sales load.[27] These exemptions were granted pursuant to § 6(c) which authorizes the Commission to grant an exemption

> "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."

Thus, Appellant would ask this Court to believe that even though § 22(d) was passed to solve the problem of dilution caused by "insider trading", as Appellant contends, the SEC immediately exercised its exemptive powers and found it consistent with the purposes fairly intended by § 22(d) to allow that very problem to continue. It then took no further action to deal with the problem until adoption of the forward pricing rule 28 years later.

Moreover, it is incongrous for Appellant to argue that Congress used the familiar anticompetitive device of retail price maintenance to solve the wholly unrelated problems of insider abuse. The fact is that when Congress intended to reach insiders by the Investment Company Act, it did so in a precise way. Thus, Congress defined the term "affiliated person" in § 2(a)(3)

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[27]See, Investment Company Act Rel. No. 2798 (January 20, 1959), CCH Fed. Sec. L. Rep., Transfer Binder, '57-'61 Decisions, ¶76, 625 at 80, 395.

to broadly encompass all persons who may have an especially advantageous relationship with an investment company. It used the term "affiliated person" throughout the Investment Company Act whenever it intended to deal specifically with problems of insider abuse.[28] But § 22(d) does not use the term "affiliated person"; instead, it speaks of "any person", with only those exceptions specified therein.

Nothing could be more indicative of the effect of § 22(d) in suppressing secondary market competition than the reaction of secondary market dealers. Aisel & Company, a major force in the secondary market, summarized its understanding of § 22(d) as follows:

> "If the provision [§ 22(d)] will achieve anything at all — and we think it was designed for this purpose — it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly."[29]

3. The SEC Has Direct Regulatory Authority Over the Alleged Unlawful Activities of Appellees and Is Exercising That Authority

Despite attempts to characterize the Commission's authority as merely "supplementary oversight" (App. Br. at 55), Appellant does not dispute the SEC's authority to deal with the precise activities of which it complains. Thus, in the 1973 Mutual Fund Distribution Hearings, Appellant urged the Commission to seek a complete legislative repeal of § 22(d) but argued that the Commission "need not wait for repeal" because it has the power under § 6(c) of the Investment Company Act to eliminate the

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[28] See, e.g., § 17 entitled "Transactions of Certain Affiliated Persons and Underwriters," 15 U.S.C. § 80a-17.

[29] Memorandum Covering S. 4108 from Robert White of Aisel & Company to Wallace Fulton, Executive Director of the NASD (August 29, 1940), Joint Appendix at 315.

adverse effects of the resale price maintenance provisions of § 22(d).[30] The Anitrust Division specifically pointed out that § 22(f) could be used to preclude the funds from using restrictive provisions to suppress the secondary market if § 22(d) were repealed. (*Id.* at 13-14).

The 1973 hearings were part of a long-standing SEC regulatory concern over price competition in the distribution of mutual fund shares, including the effect of the restrictions complained of by Appellant. Indeed, the Commission's attention was focused on this issue immediately after passage of the Act. Thus, in the 1941 SEC hearings on proposed NASD Rule 26 dealing with distribution of mutual fund shares, secondary market dealers claimed that certain provisions of the Rule would unjustly discriminate against them by impeding the transfer of fund shares in secondary market transactions and forcing such dealers to assume additional risks. The Commission refused to disapprove those restrictions observing that Congress never intended or expected "a free and open market" for mutual fund shares. As the Commission pointed out, "the nature of [mutual fund] shares and the manner in which they are distributed and redeemed are so extraordinary as perhaps to justify extraordinary treatment."[31]

At least since 1962, regulatory concern with respect to retail price maintenance has been the subject of direct and repeated communications between the Commission and Congress. In 1962, the Commission transmitted to the Congress the so-called Wharton Report[32] which, among other things, examined the effect of the regulatory pattern on the distribution of mutual fund shares. It specifically attributed the absence of retail price com-

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[30] *Comments of the Department of Justice Before the SEC Mutual Fund Distribution Hearings,* File No. 4-164, Comments of the Antitrust Division dated February 2, 1973 at 2-3.

[31] Exchange Act Release No. 2866 (April 12, 1941); 9 SEC 38, 44-46.

[32] *A Study of Mutual Funds,* Wharton School of Finance and Commerce of the University of Pennsylvania, H.R. Rep. 2274, 87th Cong., 2d Sess. (1962).

petition to the provisions of § 22(d), NASD Rule 26 and the sales agreements of which Appellant now complains. (*Id.* at 31-35).

In 1963, the Commission transmitted to Congress its Special Study of the Securities Markets [33] which discussed in some detail the effect of the restrictions contained in the sales agreements on the secondary market. The Study concluded that the retail price maintenance system created by § 22(d) warranted "further consideration."[34]

In 1966 the Commission reported its "further consideration" to the Congress in a Report on Public Policy Implications of Investment Company Growth.[35] The SEC then advised Congress that it believed the retail price maintenance provisions of § 22(d) to be primarily responsible for "excessive" sales charges for mutual fund shares. The SEC expressly considered and rejected abolition of § 22(d) because of the "unsettling and unforeseeable effects which abolition of retail price maintenance might have on the broker-dealer community,"[36] and because the benefits of price competition were not likely to flow to those most in need of protection – the unsophisticated investor.[37] The SEC recommended instead that the Investment Company Act be amended to place a flat statutory ceiling on sales charges for fund shares.

The Commission's recommendations were thoroughly considered by the Congress over a period of approximately four years prior to enactment of the Investment Company Act Amendments of 1970. Throughout hearings on those amendments, the SEC's position on § 22(d) was repeatedly questioned, and other witnesses urged modification or repeal of these restrictions on

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[33] *SEC Report on the Special Study of Securities Markets, H.R.* Doc. No. 95, 88th Cong., 1st Sess. (1963). (Hereinafter referred to as "Special Study Report").

[34] *Special Study Report,* Pt. Four at 98.

[35] *Public Policy Report, supra* at n. 21.

[36] *Id.* at 223.

[37] *Id.* at 222.

competition. It is evident from those hearings that Congress was fully aware that § 22(d) represented an exception to the antitrust laws and that the section applied to all broker-dealers.

Thus, in 1967 hearings before a House Subcommittee, then SEC Chairman Manuel F. Cohen engaged in the following dialogue:

> COHEN. The statute now, and since 1940, interferes with competitive business in this area.
>
> MR. WATKINS. Not to the extent you are proposing.
>
> COHEN. I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.
>
> MR. WATKINS. True.[38]

On the Senate side the same situation prevailed. For example, Senator Proxmire pointed out that the purpose of repealing § 22(d) would be:

> "[t]o permit price competition in the sale of the same mutual fund by various *broker-dealers*."[39]

Senator Mondale explained the effect of § 22(d), saying it "makes it illegal for *agents* to sell at a sales charge less than that prescribed by the company."[40] and later explained that "it does not prohibit or have anything to do with competition as between companies." Professor Paul Samuelson urged Congress to repeal

> "the provision in section 22(d) of the Investment Company Act of 1940 which prohibits a broker from

[38] 1967 House Hearings at 711.
[39] 1967 Senate Hearings at 51, 52.
[40] *Id.* at 769.

selling mutual fund shares to the public at less than the public offering price."[41]

Throughout these hearings the Commission impressed on Congress its concern over the uncertain results of abandonment of the price maintenance provision in § 22(d). Commissioner Owens testified:

> "[W]e were apprehensive that as a regulatory agency we could not tell you gentlemen where a repeal of 22(d) would take us. There was apprehension and there still is, I might add, that we don't know what conditions will result in the marketplace if 22(d) is repealed.
>
> We are told that wildcatting and price-cutting will be ruinous to the industry. It well might be."[42]

The Congress ultimately accepted the Commission's basic approach in the 1970 amendments. It directed the NASD, subject to SEC oversight, to set maximum sales charges and retained § 22(d) without change. The Senate Committee, however, was not satisfied that the consequences of repeal of § 22(d) had been adequately studied. Accordingly, the Committee Report stated:

> "In its deliberations your committee considered the possibility of deleting Section 22(d) from the act. However, impressive testimony was given that there had not been sufficient study of the consequences of such an amendment. Therefore, your committee requests the Securities and Exchange Commission to review the consequences of such a proposal on both the investing public and mutual fund sales organizations and report to it as soon as is reasonably practicable."[43]

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[41] 1967 Senate Hearings at 348.

[42] *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency,* 91st Cong., 1st Sess. at 18 (1969).

[43] S. Rep. No. 184, 91st Cong., 1st Sess. at 8 (1969).

Pursuant to this Congressional request the Commission transmitted to Congress the 1974 SEC § 22(d) Report. In the Report, the Commission again rejected complete abolition of § 22(d), but requested additional legislative authority to abandon § 22(d) administratively should conditions later permit. The SEC accepted the Appellant's argument that its existing statutory authority was adequate to substantially modify the system of retail price maintenance, but it differed sharply with Appellant as to how and to what extent that authority should be exercised.

The proposals announced by the Commission in the 1974 SEC § 22(d) Report graphically demonstrate the fact that the activities complained of in Appellant's Complaint are subject to the direct regulatory authority of the SEC, and that the questions raised by the Complaint are particularly well-suited to resolution by the SEC. Thus, since the likely result of an immediate lifting of the retail price maintenance requirement would be "disruption" of the distribution system, the Commission stated that it

> "has chosen a middle path, intended to reduce or eliminate many of the inequities and inefficiencies of the present fund distribution system while, at the same time, avoiding the dangers of a sudden abolition of retail price maintenance. *We have decided to exercise fully our existing administrative powers to lay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system.*" Transmittal Letter at v.

The Commission proposed a broad range of related regulatory changes which would, *inter alia,* allow price competition through brokered secondary market transactions while still

> "prevent[ing] a secondary brokered market from having an adverse impact on the primary distribution system." 1974 SEC § 22(d) Report at 109.

The Commission's Report makes clear that solution of problems and imposition of regulatory changes in the area of mutual fund distribution are best made by the SEC, rather than the antitrust courts. As stated by Chairman Garrett,

> "A regulatory agency seems particularly well-suited to perform the task of adapting the regulatory framework in response to changed conditions. It is the genius of the administrative process that the intent of Congress can be effectuated in a complex and specialized area by an agency which is provided with flexibility and discretion to adjust the law as circumstances demand." Transmittal Letter at vii, viii.

4. The Antitrust Relief Sought by Appellant is Clearly in Conflict With the Investment Company Act and With the Commission's Recent Regulatory Action

Appellant attempts to mask the obvious conflict between antitrust relief and the regulatory scheme for investment companies. It states that the SEC's "recent efforts" to move toward price competition in mutual fund retail sales "show that antitrust principles are in harmony, not in conflict, with the purposes of the Investment Company Act." (App. Br. at 58, 59). Yet, as demonstrated above, the very "recent efforts" to which Appellant points — the recommendations contained in the 1974 SEC § 22(d) Report — are themselves in conflict, not in harmony, with the result sought by Appellant in at least three respects.

First, Appellant seeks elimination of all bars to a secondary dealer market; the SEC disagrees and does not believe that a secondary dealer market should be established at this time. (Transmittal Letter at vii).

Second, Appellant seeks elimination of all restraints on a secondary brokered market; the SEC disagrees and believes that such a market should be permitted only if adequate regulatory provision is made "to help neutralize any adverse impact upon

the funds' primary distribution systems". (1974 SEC § 22(d) Report at 105).

Third, Appellant seeks full price competition now; the SEC disagrees and intends to gradually "move toward the goal of price competition in an orderly manner." (Transmittal Letter at vii).

The Commission's recommendations are premised on its understanding of the dependence of the mutual fund industry on the primary distribution system and its appreciation of the need to protect, in accordance with the Congressional mandate, the integrity of that system. Appellant's argument that there is no conflict between the antitrust laws and the pattern of regulation for the distribution of mutual fund shares, on the other hand, is based on its refusal to accept the existence of this Congressional purpose. This refusal is justified by a series of gross misstatements concerning the regulatory scheme. Appellant states:

> "[Section 22(d)] *permits* resale price maintenance with respect to the issuance and primary distribution of mutual fund shares." App. Br. at 53.

Section 22(d), in fact, *demands* retail price maintenance under threat of criminal sanction. Appellant knows that to be true, as do the Commission,[44] the Congress[45], and the Appellees.

Appellant states:

> "Taken together, these provisions [§ § 22(d), 22(f), 6(c) and 38] establish a scheme of cooperative regulation, in which underwriters, brokers and dealers are free to determine for themselves what is necessary for regulation of the mutual fund distribution network, with the Commission exercising selected supplementary powers of direct regulation and secondary supervision in the interests of the investing public." App. Br. at 54.

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[44]*Supra* at 37.
[45]Ibid.

> "Congress thus rejected a policy of pervasive direct regulation in favor of a less intrusive scheme more in keeping with free market traditions. Within the quality control constraints imposed by the rules of the association, Congress left each fund, underwriter and broker-dealer 'free to determine his own business policy' and gave the Commission power of supplementary oversight." App. Br. at 55.

Appellant is, at the very least, confused. It confuses the provisions of the Maloney Act, relating to industry self-regulation, with the pervasive direct SEC regulation contained in the Investment Company Act.

As Appellant must know, under the Investment Company Act underwriters, brokers and dealers in the area of mutual fund distribution are not "free," among other things, to deny requests for redemption (§ 22(e)), to sell new shares at less than net asset value or at other than the offering price (§§ 22(a), 22(d)), to compute net asset value as they choose (Rule 22c-1), to charge any sales load they choose (§ 22(d)) or to enter into whatever sales agreements they choose (§15(c)). They lack these freedoms because the regulatory scheme decreed by Congress has specifically denied them "free business choice" in the area of mutual fund distribution. Such denial is hardly consistent with Appellant's mistaken conception of a "less intrusive scheme" of regulation more in keeping with "free market traditions." (App. Br. at 55).

5. The SEC Also Has Authority Over the Alleged "Horizontal" Activities of Appellees

As a last-gasp effort to salvage some portion of its case from the detailed opinion of the court below, Appellant argues that Count I of its Complaint contains broad allegations of horizontal conspiracy. Appellant argues, citing *Georgia* v. *Pennsylvania R. R. Co.*, 324 U.S. 439 (1945), that the alleged horizontal

activities of Appellees are unlawful because, like the regulatory scheme in the *Georgia* case, the regulatory scheme here "did not authorize collusive action. . . ." (App. Br. at 63) However, the Court in *Georgia* did not hold that a regulatory statute has to specifically *authorize* horizontal activities in order for them to be immune from the antitrust laws. Rather, it held that collusive ratemaking activities were not immune from the antitrust laws when

> "[t]he type of regulation which Congress chose did not eliminate the emphasis on competition in rate making." 324 U.S. at 458, 459.

Thus, the "type of regulation" upon which the holding in *Georgia* rests, is far different than the regulation under the Investment Company Act in the instant case. Here, Congress unquestionably chose to eliminate the "emphasis on competition" in the retail pricing of an individual fund's shares[46]. Competition is replaced by what Appellant itself has called "a rigid system of retail price maintenance." (See, *supra* at n. 20).

The Court's primary concern in *Georgia* was not whether the regulatory statute "authorizes" horizontal activities but whether the statute subjected those activities to regulation. The Court ruled that no implied immunity existed in *Georgia* because:

> "[Congress] has not placed these combinations under the control and supervision of the Commission. Nor has it empowered the Commission to proceed against such combinations. . . ." 324 U.S. at 456.

Thus, the issue with respect to the alleged horizontal activities is the same as that with respect to the other activities of which Appellant complains: are the activities within the mainstream of the SEC's regulatory authority?

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[46] It should be emphasized that Appellant does not allege any horizontal activities relating to pricing of the various funds. The alleged "horizontal" activities relate only to intrafund pricing.

The horizontal activities alleged by Appellant consist mainly of the inducement of underwriters "to include restrictive provisions in their sales agreements," the distribution of "misleading information . . . concerning the legality of a brokerage market," and the "suppressing" of secondary-dealer market quotations (Complaint, § 17). As previously noted, Appellant has itself agreed that § 22(f) gives the SEC adequate authority to eliminate "restrictions" in sales agreements. (*supra* at 35). Moreover, the SEC's authority to deal with the distribution of "misleading" information and "suppression" of market quotations under the antifraud provisions of the Federal securities law is beyond question. Indeed, the SEC is expressly authorized to adopt rules to "define, and prescribe means reasonably designed to prevent . . . such quotations as are fictitious." (Exchange Act § 15(c)(2)).

Moreover, the SEC could reach the activities complained of through its far-reaching oversight authority contained in the Malony Act. Under that Act, the SEC may suspend or even revoke the NASD's registration for (a) any violation of the Exchange Act "or any rule or regulation thereunder," (b) "any other activity tending to defeat the purposes of" the Maloney Act or failure "to enforce compliance with its own rules."[47] In addition, the SEC may "remove from office any officer or director" of the NASD who "has willfully abused his authority."[48]

In short, the jurisdiction and authority of the SEC plainly encompasses all of the activities alleged to be unlawful in Count I. The existence of this authority in the SEC and the certainty of conflict between exercise of that authority and intervention by the antitrust courts preempts the application of normal antitrust strictures.

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[47]15 U.S.C. § 78*o*-1.

[48]15 U.S.C. § 78*o*-3(*l*)(3).

II.

THE DISTRICT COURT CORRECTLY RULED THAT BOTH SECTIONS 22(d) and 22(f) OF THE INVESTMENT COMPANY ACT EXEMPTED THE PRACTICES COMPLAINED OF FROM THE ANTITRUST LAWS.

The court below also held that the retail price maintenance system of § 22(d) and its "necessary companion", § 22(f), created a specific exemption from the antitrust laws for the practices complained of. The court stated:

> "[T]hat Congress designed § § 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is 'incompatible with the maintenance of [an] antitrust action'. *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 358 (1963)." J. S. App. at 58.

Appellant takes issue with that holding by urging that both § 22(d) and § 22(f) be narrowly construed to allow the secondary market to engage in unrestricted retail price competition with the primary distribution system for mutual fund shares. Appellant's position entirely ignores the interrelationship between the primary distribution system and the secondary market, fails to respect the Congressional intent underlying § 22(d) and § 22(f) to protect the primary distribution system, and is based on a misreading of the plain and unambiguous terms of the statutes.

A. Appellant Ignores the Destructive Impact of Secondary Market Operations

Appellant concedes that the Investment Company Act creates a specific exemption from the antitrust laws for retail price maintenance in mutual fund share distribution. (App. Br. at 20, 21). However, Appellant claims that this exemption was not intended

to protect the primary distribution system against secondary market competition and therefore is not broad enough to encompass the activities of Appellees described in the Complaint.

Appellant's argument is rooted in a basic misconception: it views the primary distribution system and the secondary market as separate and distinct markets which do not interrelate. In Appellant's view, the secondary market "cannot . . . undermine, or even adversely affect, primary distribution." (App. Br. at 20). The court below rejected Appellant's argument and stated:

> "[T]he position of the plaintiffs fails to take into account that the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urged upon Congress with no success. It is an economic fact, recognized by Congress, that the two markets — the primary market . . . and a secondary market as urged by the plaintiffs—cannot co-exist and both remain viable." J.S. App. at 46.

Appellant disregards these findings. It asserts that if a share is purchased in the secondary market, the primary distribution system, while denied the opportunity to sell that share, receives an offsetting benefit in being relieved of the obligation to redeem the share at that time. (App. Br. at 35, n. 30). However, underwriters and dealers in the primary distribution system are also deprived of the commissions on transactions in the secondary market. These commissions furnish the financing necessary to ensure the continuous distribution efforts of the primary distribution system. Absent such financing the primary distribution system could not effectively provide the liquid assets required by the funds to meet their redemption obligations while avoiding self-liquidation.

This "drying up" effect was clearly identified by the 1974 SEC § 22(d) Report to Congress which stated:

> "[S]ince mutual fund shares are continuously issued, underwriters must bear continuing distribution costs; these costs would be present even if a competitive environment has largely eliminated the need to recruit and train a sales force, since an underwriter would still have to pay for such items as the preparation of prospectuses and advertising. Since an underwriter would receive no spread on shares sold in a secondary market, it would be necessary to provide underwriters with some substitute compensation. Similarly, since contract dealers do share a portion of the sales load with the underwriter, it would be unjust if competing secondary market-makers were not also required to bear certain costs to sustain the mutual fund distribution system and to bear certain burdens in order to assure, even in a price competitive environment, that they do not enjoy an unfair competitive advantage over contract dealers *to the point of drying up fund distribution at the primary level.*" 1974 SEC § 22(d) Report at 119, 120.

The potential danger of the secondary market to the primary distribution system was highlighted by the Report. For this reason, the Commission, while announcing a program of gradual regulatory change which would permit the operation of a secondary "brokered" market for mutual fund shares, emphasized that the program should develop only "in the context of the Commission's total regulatory scheme respecting fund distribution."[49]

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[49] 1974 SEC §22(d) Report at 105. The SEC's concern with the potential adverse impact of a secondary market also was reflected in the proposal of the Report to exempt variable annuities from the strictures of §22(d). The Commission pointed out that §22(d) "has little relevance to the marketing of variable annuities" because "the nature of the product precludes the development of a secondary market." Id. at 102.

That regulatory scheme would be designed to protect the primary distribution system from the secondary market. The Report stated that:

> "steps should be taken to prevent a secondary brokered market from having an adverse impact on the primary distribution system. Specifically: (1) a fund should be able to impose a reasonable flat transfer fee; (2) orders should not be filled more than one full business day after they were received; and (3) a fund should be able to obtain an exemption from any rule under Section 22(f) upon a showing of a threat to its distribution system." 1974 SEC § 22(d) Report at 109.

The SEC's concern over unrestrained operations of a secondary market was further demonstrated in its request for legislative action. The 1974 SEC § 22(d) Report stated that the specific purpose of its request was to increase the Commission's existing administrative authority to "prevent a secondary dealer market from injuring funds and their distribution systems." (*Id.* at 121). The Report pointed out that the considerations motivating the request "are similar to those that have underlain historic objections to a secondary market in mutual fund shares." (*Id.* at 120, n. 1). The Report stated:

> "Even in a fully competitive environment, however, the nature of the mutual fund industry will demand that fund underwriters and contract dealers be protected from unfair competition on the part of secondary market-makers." *Id.* at 119.

Appellant also attempts to establish a separation between the primary distribution system and the secondary market through an analogy to second-hand goods. Appellant argues:

> "Section 22(d) was not intended to ensure that a fund would have the maximum market for its newly-issued

> shares, to be sold at the fixed price, any more than state fair trade laws are intended to protect producers from competition from the second-hand market for their goods." App. Br. at 34, 35.

Appellant's effort is disingenuous at best. It ignores the obvious fungibility of shares issued by a particular mutual fund. From the investor's viewpoint, it makes no difference whether he buys Wellington fund shares through the primary distribution system or in the secondary market. The share is the same and represents an identical interest in the fund. However, while secondary market purchasers receive the same merchandise, the primary market loses a sale. This is precisely the result § 22 was designed to prevent.

Appellant supports its thesis that § 22 of the Investment Company Act was not intended to affect the secondary market for mutual fund shares by misreading both § 22(f) and § 22(d). Appellant ignores the admonition of this court in *United States v. Hutcheson*, that "legislation should not be read in a spirit of mutilating narrowness." 312 U.S. 219, 235 (1941). *Hutcheson*, like this case, dealt with an exception to the antitrust laws. The Court admonished those who would interpret legislation to recognize "the importance of giving 'hospitable scope' to Congressional purposes even when meticulous words are lacking." (*Ibid.*). The Court, adopting the statement of Justice Holmes, said:

> "A statute may indicate or require as its justification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur to the mind. The Legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an

> adequate discharge of duty for courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before. *Johnson v. United States,* (CCA (1st), 163 F. 30, 32, 18 LRA, NS, 1194)." *Ibid.*

The court below properly followed the admonition of *Hutcheson,* and took full account of the practical context presented to the Congress when it enacted the Investment Company Act and the necessary impact which the provisions of the Act would have on the distribution system and its environment.

B. Contrary to Appellant's Contention, Section 22(d) Clearly Applies to Secondary Market Transactions

Moreover, in this case the "meticulous words" referred to in *Hutcheson* are not lacking. Section 22(d) clearly provides that no "dealer," no matter whether he acquires shares from the secondary market or through the primary distribution system, may sell to investors at other than the public offering price fixed by the prospectus. Hence, there can be no doubt that § 22(d) was intended by Congress to apply to secondary market transactions.[50]

Appellant contends, however, that § 22(d) "does not apply to transactions in mutual fund shares between investors executed through a broker." (App. Br. at 21). To support this argument,

[50] Appellant's convoluted analysis required to reach its conclusion that retail sales of mutual fund shares by non-contract dealers are in the primary distribution chain is indicative of Appellant's attempt to redefine the distribution system to conform to its preconceived antitrust concepts. Appellant (App. Br. at 7, n. 7) concludes that retail sales by non-contract dealers which, as Appellant admits, must be consummated pursuant to § 22(d) are "in the primary distribution chain." That is patently untrue; the principal distribution system is that system created by the vertical contracts among the funds, underwriters, and contract dealers. Every description of the operations of the primary distribution system—from the Investment Trust Study in 1940 to the Commission's 1974 § 22(d) Report—makes this indisputably clear.

Appellant relies on that fact that § 22(d) does not use the term "broker." Appellant argues that since Congress separately defined the terms "broker" and "dealer," it would be inappropriate to read the word "broker" into § 22(d).

Wellington does not contend that the term "broker" should be read into § 22(d). Section 22(d) only refers to "dealers," "underwriters," and "issuers." Wellington does contend, however, that the retail sellers of mutual fund shares in the primary distribution system are plainly included in the statutory definition of "dealer" in § 22(d). The statutory definition of a "dealer" is clearly and unambiguously stated in § 2(a)(11). "Dealer" means *"any person regularly engaged in the business of buying and selling securities for his own account."* Appellant disregards the phrase "regularly engaged in the business of" in that definition. It interprets the terms "dealer" as if Congress had defined it in a "transactional sense" because "parties involved in securities transactions act in different capacities at different times." (App. Br. at 23).

However, § 2(a)(11) makes clear that Congress did not define the term "dealer" in a transactional sense. Under the § 2(a)(11) definition, a "dealer" cannot evade the prohibitions of § 22(d) and sell fund shares at less than the public offering price simply by choosing to *act* as a "broker" in a particular transaction. To construe § 22(d) to give sellers of fund shares such unbridled discretion would be entirely inconsistent with Appellant's characterization of § 22(d) as a rigid scheme of retail price maintenance. (*Supra* at 26).

Appellant cites no reason why, for purposes of § 22(d), the term "dealer" should not mean what Congress plainly said it meant in § 2(a)(11). As Appellant points out, Congress used the terms "broker" and "dealer" in a precise fashion, depending on what it wanted to accomplish. (App. Br. at 22, n. 17). That same Congressional precision demonstrates that when Congress intended to use the term "broker" or "dealer" in a transactional sense, rather than in a status sense, it knew how to do so. Thus,

in § 17(e)(2) Congress stated with respect to brokerage transactions executed by affiliated persons of a registered investment company:

> "It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person—
>
> (2) *acting as broker* in connection with the sale of securities to or by such registered investment company or any controlled company thereof, to receive from any source a commission, fee, or other remuneration for effecting such transaction which exceeds [the limitations set forth in that section.]"[51]

In contrast, § 22(d) does not refer to persons "acting as a broker" or "acting as a dealer." It uses only the term "dealer." And there is nothing in the language of the Act, the context of the distribution system in existence at the time the Act was passed, or the legislative history of the Act which suggests that Congress intended the term "dealer" in § 22(d) to have any meaning other than that specified in § 2(a)(11). Accordingly, all dealers regularly engaged in the business of selling shares to the public are "dealers" as defined in the Act for purposes of § 22(d), and even absent the sales contracts, they could not, through the label of "brokerage transaction," sell mutual fund shares to the public at less than the public offering price.

C. Appellant's Reliance on So-called "Long-standing SEC Interpretations" Is Misplaced

To support its contention that a dealer may evade the prohibitions of § 22(d) simply by choosing to label a particular transaction as a "brokerage transaction," Appellant relies on what it characterizes as a "long-standing SEC interpretation of § 22(d)." However, from thirty-four years of SEC administration of the

[51]See also, the language in §§ 17(a) and 17(d), ("acting as principal"); § 17(e)(1), ("acting as agent"); § 2(a)(8) and 2(a)(17), ("acting in his capacity as such").

Investment Company Act, Appellant is able to present only five items as evidence of this "long-standing interpretation."

Each of these items suffers from the infirmity of Appellant's own argument: none attempts to reconcile itself with the clear and unambiguous meaning of the word "dealer" in § 2(a)(11). None even mentions § 2(a)(11). Thus, the significance of Appellant's five items of evidence is subject to serious question.

Appellant places primary reliance on a 1941 opinion of the SEC's General Counsel[52] which, in response to a hypothetical question states: "In my opinion, the term 'dealer' as used in section 22(d), refers to the capacity in which a broker-dealer is acting in a particular transaction." The opinion provides no rationale for that conclusion. It neither refers to the statutory definition of "dealer" in § 2(a)(11), nor gives any clue as to why that term, as used in § 22(d), should have any different meaning in that section than in the rest of the Act. Plaintiff also relies on *In the Matter of Oxford Company*, 21 S.E.C. 681 (1946). There the Commission revoked the registration of a two-man broker-dealer firm for engaging in grossly fraudulent practices in connection with the accounts of two elderly ladies. In discussing those activities the Commission adopted the rationale of the 1940 General Counsel's opinion referred to above. However, the Commission did not consider whether, much less make a finding that, the broker was "regularly engaged in the business of buying and selling securities for his own account" and was thus a "dealer" as defined by § 2(a)(11).

Appellant's other items of evidence[53] offer no more analysis than the two cited above and are little other than reiterations of the unsupported statements noted above. Indeed, even the Commission's most recent pronouncement in its Report on § 22(d) provides no analysis of the definition of "dealer." The Report merely stated that:

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[52] Investment Company Act Rel. No. 87 (March 14, 1941), 3 CCH Fed. Sec. L. Rep. ¶48,774.

[53] *Mutual Funds Advisory, Inc.*, Investment Company Act Release No. 6932 (Jan. 12, 1972); *Opinion of Chief Counsel*, SEC Division of Investment Mgmt. Reg. (April 24, 1973), see Joint Appendix at 246, 247.

> "The Commission and its staff *have consistently taken the position* that Section 22(d) is inapplicable where an individual fund shareholder sells his shares through a broker to another person." 1974 SEC § 22(d) Report at 104.

The Report does not offer any explanations as to *why* or *on what basis* the Commission and its staff have "consistently" taken that position. The conclusion of that Report, however, perhaps provides a clue. There, the Commission made it clear that it does not now view a limited secondary brokerage market with prescribed safeguards, as a threat to the primary distribution system.

But, as the court below noted with respect to the earlier Commission pronouncements, the Report, even as so interpreted, does "not address the problem of likely discrimination between similarly situated investors." (J.S. App. at 67-68, n.61).[54] The court pointed out that the prevention of price discrimination is a "corollary" to the "price maintenance purpose of § 22(d)." The Commission itself has repeatedly recognized that the prevention of price discrimination among similarly situated investors is a principal purpose of § 22(d). See, *In the Matter of Investors Diversified Services*, 39 S.E.C. 680 (1960) where the Commission stated:

> "The purposes of the Section § 22(d) are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus."[55]

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[54] In the 1974 SEC § 22(d) Report, the Staff attempts to rationalize Commission decisions relating to discrimination with their position on the definition of "dealer." As pointed out below, however, even such interpretations cannot overcome the plain meaning of the statute.

[55] *In the Matter of Variable Annuity Life Insurance Company of America*, Investment Company Act Release Nos. 2974 and 2975, February 25, 1960; CCH Fed. Sec. L. Rep., Transfer Binder '57-'61 Decisions, ¶76,688; *In the Matter of Mid-America Mutual Fund, Inc.*, Investment Company Act Release No. 3612, January 11, 1963; CCH Fed. Sec. L. Rep., Transfer Binder '61-'64 Decisions, ¶76,894.

Indeed, the concern over such price discrimination was a principal reason why the Commission chose sales load limitations rather than the elimination of § 22(d) to deal with the problem of "excessive sales charges" in its recommendations to Congress that preceded enactment of the 1970 amendments to the Investment Company Act.[56]

Under these circumstances, the so-called long-standing interpretation of the SEC is not sufficient to permit Appellant or this Court to disregard the clear and unambiguous terms of § 2(a)(11). Indeed, this Court has made clear that even a contemporaneous administrative construction of a statute "is only one input in the interpretational equation." (*Zuber* v. *Allen*, 396 U.S. 168, 1[illegible] (1969)). Such administrative construction does not permit a court to "abdicate its ultimate responsibility to construct the language employed by Congress." *Id.* at 193.[57]

In *Zuber*, the Supreme Court outlined the essential requirements supporting an administrative construction of statutory language that must be found before that construction can be accorded great weight by the courts. These requirements are: (a) that the administrative construction was made known to the Congress either in drafting the initial legislation or in its reenactment; (b) that there be no evidence that Congress differed with the administrator; and (c) that there be evidence that the administrative construction "enhances the general purposes and policies underlying the legislation." (396 U.S. at 192, 193). Only if these requirements are satisfied should the courts "re-

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[56] *Supra* at 36.

[57] In the present case the definition of "dealer" as set forth in § 2(a) (11) leaves nothing to construction. "The meaning of a statute, clear and unambiguous on its face, may not be varied by administrative decisions." (*Verbeem* v. *United States*, 154 F. Supp. 431, 434 (E.D. Mich. 1957)), *Aff'd, sub nom., Amlin* v. *Verbeem*, 356 U.S. 676 (1958)). As the Supreme Court has stated in *Norwegian Nitrogen Products Co.* v. *United States*, 288 U.S. 294, 315 (1933):

> "[A]dministrative practice *does not* avail to overcome a statute so plain in its commands as to leave nothing for construction. . . ."

solve any *ambiguity* in favor of the administrative construction . . . ." (*Id.* at 192).

In this case, the clear and unambiguous languge of § 2(a)(11) leaves nothing to "resolve in favor of administrative construction." There is absolutely no evidence that Congress knew of the SEC interpretation in 1940 or when § 22(d) was reenacted without change in 1970. In fact, the evidence is to the contrary. The legislative history of the 1970 Amendments (*supra* at 37-38) indicates clearly that all participants in those hearings, whether from the industry, the SEC, or the Congress itself, believed that the retail price maintenance provisions of § 22(d) were all pervasive. No one believed they could be circumvented by the simple device of a dealer's decision to execute a particular transaction as a broker.

As was the case in *Zuber*, the alleged administrative construction relied on by Appellant does not contribute to the "broad general purpose" of § 22. Indeed, it would only undermine the rigid retail price maintenance that Congress has mandated in the sale of mutual fund shares and permit the very practices which Congress sought to eliminate.

That the SEC has now determined that a secondary brokerage market, properly regulated and with significant safeguards, will not pose a threat to the primary distribution system cannot alter the fact that in 1940 Congress viewed all secondary market competition as potentially disruptive. Accordingly, the conduct of Appellees in inhibiting that competition, as authorized by the statute and in accordance with its purposes, cannot now be transformed into antitrust violations of 34 years duration.

D. Congress Intended Section 22(f) to Authorize the Restrictions Complained of by Appellant

Although Appellant contends that this Court should accept the SEC's administrative interpretation of § 22(d), it urges the Court to ignore the SEC's interpretation that § 22(f) extends to the alleged unlawful restrictions complained of here. Indeed, Ap-

pellant would even have this Court ignore Appellant's own argument to the Commission in 1973 that § 22(f) grants the SEC adequate authority to outlaw such restrictions.

Appellant thus argues that Appellees' alleged restrictive agreements are not "of the sort" covered by § 22(f). Appellant reaches this conclusion by simply characterizing the agreements as restraints on "the distribution mechanism" rather than restraints on "fund shares" within the scope of § 22(f). Appellant's argument flies in the face of the broad language of § 22(f) which permits a mutual fund to "restrict the transferability or negotiability" of its securities, if the restrictions are disclosed in the fund's registration statement and do not contravene "such rules and regulations as the Commission may prescribe in the interest of the holders of all of the outstanding securities of such investment compan[ies]."

Appellant's attempt to artifically limit the reach of § 22(f) disregards the legislative history of that section (*supra* at 27-32). That history makes clear that § 22(f) was designed to give the SEC regulatory authority to limit the use of restrictions on transferability used by mutual funds prior to 1940 to combat what the SEC spokesman had characterized as the "big problem" of switching posed by the "bootleg" market. The provision initially proposed by the SEC merely would have authorized the SEC to prohibit such restrictions. The provisions of § 22(f), as finally enacted, went further and sanctioned such restrictions unless the SEC, in its discretion, determined otherwise by rule or regulation. The restrictions disclosed to Congress in 1940 which prompted the enactment of § 22(f) were as much restrictions on "the distribution system" then in effect as are the restrictions complained of in this case. They had one purpose—to restrict the transfer of fund shares outside the vertical primary distribution system.

Finally, and perhaps most importantly, since passage of the Act the SEC has been fully aware of the contractual restrictions here complained of, has attributed the nature of the primary distribution system as it now exists in part to the contracts in

which those restrictions are contained, and has acknowledged that such restrictions are authorized by § 22(f).

CONCLUSION

For the reasons stated above the decision of the District Court for the District of Columbia should be affirmed.

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January, 1975

APPENDIX

Pertinent Provisions of the Investment Company Act of 1940, 15 U.S.C. § 80a-1, et. seq.

SEC. 2. (a) When used in this title, unless the context otherwise requires—

(11) "Dealer" means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

SEC. 6. (c) The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

SEC. 22. (a) A securities association registered under section 15A of the Securities Exchange Act of 1934 may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may

sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or surrendering for redemption any such redeemable securities in contravention of said rules.

(b)(1) Such a securities association may also, by rules adopted and in effect in accordance with said section 15A, and notwithstanding the provisions of subsection (b)(8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its members from purchasing, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers,

and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operaing costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(b)(2) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 15(b)(10) of the Securities Exchange Act of 1934 as are appropriate to effectuate the purpose of this subsection with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 15(b)(8) of that Act: *Provided*, That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(b)(3) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule respecting excessive sales loads) the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 15A(k)(2) of the Securities Exchange Act of 1934.

(b)(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on the date this subsection takes effect, the provisions of this subsection shall prevail.

(c) The Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any registered securities association, to the same extent, covering the same subject matter and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members. Any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 including any offer made pursuant to section 11 (b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satis-

faction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except—

(e)(1) for any period (A) during which the New York Stock Exchange is closed other than customary week-end and holiday closings or (B) during which trading on the New York Stock Exchange is restricted;

(e)(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

(e)(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection. Any company which, as of March 15, 1940, was required by provision of its charter, certificate of incorporation, articles of association, or trust indenture, or of a bylaw or regulation duly adopted thereunder, to postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this title, or upon the repeal or amendment of such provisions, or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

(f) No registered open-end company shall restrict the tranferability or negotiability of any security of which it is the issuer

except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interest of the holders of all of the outstanding securities of such investment company.

(g) No registered open-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or distribution to its security holders or in connection with a reorganization.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA,

Appellant,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al.*,

Appellees.

On Appeal from the United States District Court for the District of Columbia

---

BRIEF FOR THE APPELLEE VANCE, SANDERS & COMPANY, INC.

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On Appeal from the United States District Court for the District of Columbia

---

BRIEF FOR THE APPELLEE VANCE, SANDERS & COMPANY, INC.

Appellee Vance, Sanders & Company, Inc., is the principal underwriter of a number of open-end investment companies and is a member of the appellee National Association of Securities Dealers, Inc. In the court below, Vance, Sanders moved to dismiss the complaint of the United States on the grounds, *inter alia,* that the practices alleged in the complaint are immune from attack under the antitrust laws by reason

of Sections 22(d) and 22(f) of the Investment Company Act of 1940, 15 U.S.C. 80a-22(d) and 80a-22(f). The district court, on this basis, dismissed the complaint and the appeal by the United States from that decision presents questions of law applicable to all appellees. For the reasons stated in the briefs filed on behalf of the other appellees, the appellee Vance, Sanders submits that the judgment below should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1974

No. 73-1701

UNITED STATES OF AMERICA,

Appellant,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al.,*

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR FIDELITY FUND, INC. AND THE CROSBY CORPORATION

Question Presented

The Investment Company Act of 1940 ("the 1940 Act") establishes a system of fixed prices for the sale of mutual fund shares (§ 22(d)), and sanctions the right of the funds to restrict the transferability and negotiability of their shares, absent SEC disapproval (§ 22(f)). The statute also clothes the Securities and Exchange Commission ("the SEC") with broad supervisory and regulatory power over industry activity in general and the pricing and distribution of shares in particular; accordingly, for the past 35 years the SEC has been acting as the surrogate of Congress in monitoring and controlling industry operations.

In appearances before Congressional committees and at SEC hearings the Department of Justice has over many years repeatedly but unsuccessfully contended for the abolition of all restraints on competition in the pricing and distribution of fund shares in both primary and secondary markets, whether by outright repeal of § 22(d) or by the exercise of SEC authority under § 22(f), or by resort to the SEC's pervasive regulatory power under the 1940 Act. Frustrated by the futile pursuit of this sweeping objective, the Department's Antitrust Division now seeks accomplishment of the same design by an antitrust injunction. In this effort the appellant challenges under the antitrust laws long-established contractual restrictions on the pricing, transferability and negotiability of shares, well known to the SEC, but not limited nor proscribed by that agency.

After probable jurisdiction of this appeal had been noted, the SEC published on November 9, 1974 a report entitled "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940" ("the 1974 Report"). This intervening event brings sharply into focus the basic conflict in this case: the jurisdictional clash between the Department of Justice, seeking the immediate nullification and prohibition of long-standing industry practices through application of the Sherman Act, and the SEC, recommending that these same practices be continued but gradually modified on an experimental basis under the 1940 Act by administrative action and, where necessary, Congressional amendment. The 1974 Report proposes a series of specific concrete steps by appellee National Association of Securities Dealers ("NASD"), by Congress and by the SEC itself, regarding the very subject matter of this litigation, namely, price competition in the retailing of mutual fund shares in secondary markets. Therefore, as we believe, the fundamental question presented is:

> Does the existence and exercise by the SEC of its Congressionally delegated power to supervise and regulate the pricing and marketing of mutual fund shares exempt the alleged restraints on competition from application of the Sherman Act?

The questions presented to the court below and those stated in appellant's brief in this Court are all subsumed in this basic issue of antitrust immunity for closely regulated, supervised and approved conduct.

Statutes Involved

Sections 22(d) and 22(f) (15 U.S.C. §§ 80a-22(d) and (f)) of the 1940 Act provide:

> "(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. * * *
>
> "(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company."

Proceedings and Opinion Below

After issue had been joined, the appellees moved to dismiss the Complaint on the ground that the practices challenged were as a matter of law immune from antitrust attack by virtue of the 1940 Act. The appellant responded with an affidavit and thirty exhibits to support the Complaint. Upon a finding that the 1940 Act, either by express provision or necessary implication, conferred antitrust immunity for the conduct alleged in the Complaint, even as amplified by the appellant's affidavit and exhibits, the Complaint was dismissed on the merits.[1] The dismissal rested, not upon resolution of issues of fact, but purely on principles of antitrust immunity as applied to the facts presented.

Statement of the Case

The filing of the 1974 Report with Congress casts new light on the fundamental issue presented. Before discussing the Report's recommendations, however, we should briefly describe the mutual fund marketing structure established by Congress and the erosion of that structure which appellant would achieve through the injunctive relief it seeks.

The Marketing of Shares

Appellee Fidelity Fund, Inc. ("Fidelity") is an "open-end management investment company" as defined in the

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[1] In addition to dismissing the instant case, the District Court also dismissed two private treble damage class actions alleging similar antitrust violations; the court also stayed proceedings in more than 40 other similar treble damage class actions which had been transferred to its jurisdiction by the Judicial Panel on Multidistrict Litigation. Appeals from the dismissal of the private class actions have been docketed in the Court of Appeals for the District of Columbia Circuit, and are now stayed pending disposition of this appeal.

1940 Act,[2] commonly known as a mutual fund. As required by the statute,[3] Fidelity sells its shares under a written agreement with its principal underwriter, appellee The Crosby Corporation ("Crosby"), whereby Crosby acts as sole distributor of Fidelity shares. Crosby, in turn, enters into agreements in writing with retail dealers (some of whom are named as appellees) to sell Fidelity shares to the public. This fund-underwriter-dealer chain is known as the "primary distribution system" for the sale of mutual fund shares.

Fidelity's only assets are shares in other corporations. The daily market value of these shares, plus cash on hand, less the fund's current liabilities, constitutes the "net asset value" of Fidelity's shares. Fidelity shares are issued continuously and sold at net asset value, plus a commission divided between Fidelity's principal underwriter and the dealers, known as the "sales load," ranging from 1% to 8.5% of the purchase price, depending upon volume. This "public offering price" is the price which must be charged the purchasing investor as required by § 22(d) of the 1940 Act. Fidelity also guarantees to redeem its shares upon demand at net asset value (Complaint, par. 9; App. p. 7).[4]

The funds are obliged to file a registration statement with the SEC that must be kept current with the continual issuance of fund shares. It is undisputed that the Crosby-dealer contracts, containing the restrictions on competition here questioned, have been regularly filed with and disclosed to the SEC. Indeed, these restrictions have remained substantially unchanged before and since Fidelity's

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[2] 15 U.S.C. §§ 80a-3, 4 and 5.

[3] 15 U.S.C. § 80a-12(b).

[4] Citations denoted "App." are to the printed Appendix on Appeal.

first filings shortly after passage of the 1940 Act (Loring affidavit, par. 7; App. p. 156).[5]

Alleged Antitrust Violations

The agreement between Crosby and dealers in Fidelity shares provides, and has substantially provided since 1940, as follows:

> "You [the dealer] agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the net asset value then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the then currently effective applicable Fund Prospectus), unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling to us for the account of an investor any shares of the appropriate Fund at the net asset value price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.
>
> "You agree that you will not withhold placing a customer's order in such manner as to profit your-

---

[5] There is no dispute as to the nature of the statutory mutual fund marketing structure and its effects on price competition. As this Court has described the market that "the [1940] Act creates and regulates" in *U.S.* v. *Cartwright,* 411 U.S. 546, 549 (1973):

> "Private trading in mutual fund shares is virtually nonexistent. Thus, at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund, at the 'asked' price, which includes the load. But shareholders 'sell' their shares back to the fund at the statutorily defined redemption or bid price."

self as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders, already received, and then only at the public offering price at which such orders were taken less the dealer discount allowed hereunder. We will not accept a conditional order for shares of the Fund."[6]

The Complaint alleges that these provisions prohibit Fidelity's contract dealers from acting as brokers in sales transactions at less than the public offering price, thereby improperly restricting the development of a brokerage market in previously issued shares (a "secondary brokerage market") (Complaint, pars. 23(a), 24(a), 29, 30(a); App. pp. 10, 11, 12). Were such restrictions enjoined, it is claimed, a mutual fund purchaser could acquire shares through a broker who could obtain them from a fund shareholder rather than from the fund underwriter, charging only a brokerage commission in place of the full sales load (Appellant's Brief, p. 10). This, it is asserted, would engender retail price competition.[7]

It should be observed here that the purchase price of mutual fund shares is the result of (1) free and open competition in the securities markets where the portfolios of each fund are traded daily; and (2) competition among the funds in the investment expertise each has to offer prospective investors. In other words, the net asset value of fund shares, which comprises more than 90% of the public offer-

[6] Fidelity Answer, Exh. A; App. pp. 36-37. The defense of antitrust immunity was also raised in Fidelity's Answer. Pars. 25, 27; App. p. 32.

[7] In other words, the contract dealer, required by his Crosby contract to sell Fidelity shares as part of the primary distribution system, is to be set free to act as a freelance "broker" in the sale of already issued shares from a Fidelity shareholder to a new investor, in competition with Crosby, Fidelity's underwriter, and with Fidelity itself—the issuer of the shares.

ing price and also constitutes the entire redemption price, is determined by unrestrained competition in the securities markets. Hence, it is conceded that only the load or sales commission can be affected by unrestricted sales in secondary markets (Appellant's Brief, p. 9), and it is the sales load that is the target of this suit. The sales loads vary from fund to fund, and are not fixed by agreement among the funds; and no such agreement is alleged in the Complaint. Nevertheless, the appellant seeks through injunctive relief to open up the sales load to competitive forces in secondary markets and it pursues this goal despite the deliberate decision of Congress that the sales loads be continued, subject only to SEC-NASD regulation limiting them to "reasonable" amounts.[8]

The Complaint also alleges that the dealer agreements require dealers to obtain shares for resale to customers exclusively from the fund underwriter (Complaint, pars. 23(b), 29; App. pp. 10-11, 12), whereas, it is claimed, if dealers were permitted to purchase shares directly from fund shareholders, they would find it profitable to pay somewhat above the net asset value that the selling shareholder would otherwise receive on redemption (Appellant's Brief, p. 10). The dealer could then resell at the full public offering price as required by § 22(d), but would not be required, as he is now when he sells shares obtained from the fund underwriter, to share the sales load with the underwriter. Manifestly, public benefit in a secondary dealer market would be minimal because the sales load would still be maintained.

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[8] 15 U.S.C. § 80a-22(b)(1).

SEC Consideration of and Recommendations Regarding the Same Restraints on Competition in Secondary Markets Here Sought to be Removed by Antitrust Injunction

The 1974 Report deals explicitly and exhaustively with retail price competition in secondary markets. It presents to Congress (at whose request it is made) recommendations regarding the extent to which the SEC considers this competition to be presently in the interests of the investing public, together with such safeguards as are deemed necessary to insure protection for the primary distribution system.

Five features of the Report are of primary significance: First, the SEC recommends, whether by Congressional legislation, Commission rule, or industry (NASD) self-regulation, the gradual elimination of existing contractual restrictions on a secondary *brokerage* market only, and only insofar as this is deemed presently warranted economically and in the best interests of the industry, investors and general public. Second, the SEC also recommends the indefinite postponement of similar action regarding competition in a secondary *dealer* market as untimely, unwise and economically unpredictable. Third, the Report, and its recommendations for proposed action or inaction, are an exertion of unquestioned SEC power, fully authorized by the 1940 Act and indeed conceded by the appellant. Fourth, the Report is the result of careful expert investigation made at the request of Congress. Fifth, the SEC addresses itself specifically to secondary broker and dealer market competition and the regulation of the sales load—*the identical subject matter of this antitrust action.*

Whatever disagreement there may be, whether among the appellees, between the SEC and the Department of

Justice or elsewhere, as to the soundness and efficacy of the Report's recommendations, there can be no doubt that it is legislative and administrative action, not antitrust litigation, that Congress has been and is now looking to as the solution to the problems of competition, if there be any, in the marketing of mutual fund shares.

The development of the 1974 Report exemplifies the far-reaching SEC jurisdiction in this area. In 1962, the SEC, pursuant to its authority under the 1940 Act, sent to Congress a wide-ranging study of the mutual fund industry[9] (the *Wharton Study*), including the question of sales loads and the treatment of investors in purchasing and selling mutual fund shares. This report was followed by a further exhaustive study of the securities markets, released and presented to Congress in 1963[10] (the *Special Study*) which again contains a probing analysis of sales loads and their impact on investors. An additional study of the mutual fund industry was submitted to Congress in 1966[11] (the *Public Policy Report*). In 1967 the SEC submitted its recommendations for remedial legislation to Congress, and lengthy hearings were held in both the Senate and House that year and in the years next following regarding suggested legislative changes in the mutual

[9] Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H. Rep. No. 2274, 87th Cong., 2d Sess. (1962) (*Wharton Study*).

[10] *Report of Special Study of Securities Markets of the Securities and Exchange Commission*, H. Doc. No. 95, 88th Cong., 1st Sess. (1963) (*Special Study*).

[11] *Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth*, H. Rep. No. 2337, 89th Cong., 2d Sess. (1966) (*Public Policy Report*).

fund marketing structure.[12] Because § 22(d) was considered by all, including the Department of Justice, to be the bastion of the price maintenance system, most attention was directed to the advisability of repeal or modification of that section.

However, although Congress in 1970 amended the 1940 Act in other respects, it neither repealed nor amended § 22(d). Instead, the SEC was requested to study still further the possible economic impact of a repeal of that section.[13] In response, the SEC first issued in 1972 a preliminary report discussing the many complex factors (pro and con) to be taken into account regarding possible repeal of § 22(d).[14] The SEC then held extensive hearings, in which the Department of Justice prominently participated.[15] Thus, the 1974 Report is actually the culmination of more than ten years of administrative and legislative study of the possible effects upon the mutual fund marketing system

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[12] Hearings on S. 1659 before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. (1967) (*1967 Senate Hearings*); Hearings on H.R. 9510 & 9511 before The Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce, 90th Cong., 1st Sess. (1967) (*1967 House Hearings*); Hearings on S. 34 & S. 296 before The Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. (1969) (*1969 Senate Hearings*); Hearings before The Subcomm. on Securities of the Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. (1969).

[13] S. Rep. No. 91-184, 91st Cong., 1st Sess. (1970).

[14] *Report of the Staff of the SEC on the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* (November, 1972) (*1972 Staff Study*).

[15] *In The Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940*, SEC File No. 4-164 (1973) (*1973 SEC Hearings*).

of permissive competition.[16] The present peremptory incursion of antitrust enforcement into this ongoing deliberative administrative and legislative process is a disruptive intrusion; and it ignores the legislative history we have described, which manifests the clear intent of Congress that the SEC have exclusive supervisory and regulatory jurisdiction over the pricing and distribution of mutual fund shares, subject only to continuous Congressional control.

The 1974 Report, addressing itself to the *identical* industry practices here attacked, now recommends:

As to Competition in a Secondary Brokerage Market

After detailed discussion and analysis, the Report

> ". . . recommends that the Commission now act in this area and request the NASD to amend its Rules of Fair Practice to prohibit restrictions against a secondary brokered market. We also recommend that, if necessary the Commission promulgate a rule under Section 22(f) to prevent funds from accomplishing the result presently obtained in sales agreements by restricting the transferability of their shares. However, steps should be taken to prevent a secondary brokered market from having an adverse impact on the primary distribution system." (p. 109)

As to Competition in a Secondary Dealer Market

The Report expresses the view that the time and climate are not right for introduction of competition in a secondary dealer market. In this connection it states:

> "Development of a secondary brokered market would depend on demand for fund shares and the

[16] As put by SEC Chairman Garrett in his letter transmitting the 1974 Report to Congress (page ii): "The subject of mutual fund distribution has been an important part of a series of reports and studies made for and by the Commission over more than a decade."

compensation available, which would be competitively determined . . . Such a limited secondary brokered market would not disrupt the primary distribution system, and *it would introduce possible price variations and provide insight into whether a secondary dealer market could function effectively.*" (p. 109)[17]

As to the Regulation of Sales Loads

The Report reviews the Congressional decision in 1970 refusing to impose a legislative ceiling on sales loads, instead giving the NASD regulatory authority over the amount of the load. It then recommends that the SEC not oppose a pending NASD rule on maximum sales loads, basing its decision on the fact that the proposed NASD rule is the result of an exhaustive study of sales loads undertaken by the NASD. (pp. 122-127)

As to Broadened Price Competition in the Future

The Report expresses the hope that, stimulated by the SEC and the NASD, the funds may voluntarily adopt price variations in the primary distribution system through applications to the SEC for exemptions (under § 6(c) of the 1940 Act) from the prices mandated by § 22(d). However, it is speculated that the industry might "unduly resist implementing the price variations which would be necessary first steps toward retail price competition . . . ." In that eventuality, the Report recommends "that the Commission ask Congress to amend Section 22(d) to provide the Commission with adequate authority to *require* price variations such as those described." This authority, the Report suggests, "could be exercised upon a finding that the industry had failed to move toward price compe-

[17] Unless otherwise indicated, italics in quotations throughout this brief are supplied.

tition voluntarily, and that such failure was not justified by the likelihood of serious adverse consequences for the fund distribution system" (p. 115). However, even in making this recommendation the Report cautions: "There is, of course, a necessity to avoid disruption of the fund distribution system" (Id.).

As the ultimate desideratum, the Report contemplates a time when "it should be feasible to eliminate retail price maintenance with respect to *all* mutual fund retailers; the secondary market would not be prohibited and contract as well as non-contract dealers would compete with each other" (p. 119).

The need is again emphasized, however, that "fund underwriters and contract dealers be protected from unfair competition on the part of secondary market-makers." These anti-competitive safeguards are enumerated in detail (pp. 119-121).

The Conflict Between the SEC and the Antitrust Division

Obviously, the SEC and the Department of Justice are now on a collision course regarding their views as to the need for price competition in the marketing of mutual fund shares. The conflict is sharply drawn in the 1974 Report, which notes that

> "the Department of Justice urged *an immediate end to retail price maintenance*, either by legislative or administrative action." (Report, p. 9)

Conversely,

> "The Commission is committed to the general proposition that the securities industry should operate—to the extent possible—in an environment of free and vigorous price competition. *In the mutual fund industry, however, the Division does not be-*

> *lieve that it would be possible to move quickly to retail price competition without seriously disrupting the distribution of fund shares.* In view of the open-end self-liquidating nature of mutual funds, such disruption should be avoided, if at all possible, and certainly minimized." (Report, p. 10)

The same policy conflict flares in this litigation. The Department would nullify and prohibit all contractual restraints on competition in secondary dealer and brokerage markets as violations of the antitrust laws, regardless of the economic consequences to the primary distribution system established and maintained after Congressional deliberation and command. The SEC, on the other hand, while recommending the gradual lifting of contractual restraints upon a secondary brokerage market, regards as untimely and inadvisable the elimination of such restraints on a secondary dealer market. And even in advising a degree of permissive secondary brokerage market competition, the SEC recognizes the possible unknown and presently unknowable adverse effects on the primary distribution system and recommends advance adoption of specific safeguards against these consequences.

In the event that the sweeping injunction here sought by the Department of Justice were granted, it is quite impossible to perceive how the recommendations of the 1974 Report could legitimately be promoted or adopted by the SEC. For certainly, a decree enjoining as violations of the Sherman Act the alleged existing restraints on competition in secondary dealer and broker markets would preclude any SEC temporizing with those restraints and prohibit

their continuance even in the modified form recommended in the 1974 Report.[18] Indeed, those recommendations themselves might well become violations of the antitrust injunction.

The appellant does not gainsay the jurisdiction of the SEC over the subject matter of the 1974 Report, nor its power to adopt and administer, subject to Congressional approval, the recommendations contained therein. The only question then, is whether that jurisdiction is exclusively the SEC's or concurrently the Justice Department's. Common sense leads to the conclusion that these two conflicting regimes cannot govern simultaneously in the same field, and that the mutual fund industry could not continue to prosper under this Janus-faced supervision and control.

Fortunately, Congress has provided the solution. In the 1940 Act it conferred upon the SEC a regulatory power over the industry, and particularly over the pricing of mutual fund shares, so pervasive as to raise the inevitable presumption of a Congressional exemption of this area from the antitrust laws. This is demonstrated by the provisions and the legislative and administrative history of the 1940 Act.

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[18] For example, the Complaint seeks an order enjoining the appellees from imposing "any limitation" upon the dealer's right to act as broker or as to whom he may sell shares or from whom he may buy them (Complaint, par. 3, prayer for relief; App. p. 18). Yet the Report recommends *against* elimination of contractual restrictions on a dealer market, and proposes that dealers need not attempt to match buy and sell orders as brokers unless such orders are received within the same 24 hour period. These recommendations propose market "limitations" which the appellant would eliminate entirely. In addition, in order to protect the primary distribution system, the Report recommends permitting the imposition of a transfer fee in secondary market transactions to compensate the underwriter for the loss of the portion of the sales load he would otherwise receive (Report, p. 106).

Mutual Fund Marketing Conditions Before the 1940 Act

Prior to 1940, mutual funds were sold in a chaotic marketing environment. Funds distributed their shares through underwriters as they do today. For example, the Fidelity-dealer sales agreements existing before the 1940 Act contained restrictions nearly identical to those now being challenged for the first time by the appellant many years later. As found by a four-year SEC study of the investment company industry submitted to Congress at its request in 1939,[19] there was retail price competition engendered by a "bootleg market" in mutual fund shares maintained by freelance dealers not bound by contract to any fund or underwriter, and hence not limited by the restrictions imposed on contract dealers. As a consequence, they bought from shareholders at "a little more than the published redemption price" and sold at a "little less than the published sale price."[20]

The bootleg market thus described is of importance here in two principal respects: First, its dealers were trading shares in a secondary market precisely as the appellant urges the antitrust courts to require today, *i.e.*, buying from investors at above the redemption price (secondary dealer activity) and selling at less than the public offering price (similar to secondary broker activity). Second, contract dealers, if circumstances required, were free to sell

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[19] Report of the SEC, *Investment Trusts and Investment Companies, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Companies*, H.R. Doc. No. 276, 76th Cong., 1st Sess., p. 865 (1939) *(Investment Trust Study)*.

[20] *Id.*

fund shares to non-contract dealers. As the *Investment Trust Study* put it:

> "A certain amount of protection was received by such [bootleg] operators through their ability to obtain shares from the legitimate distributors if these dealers were short." (p. 865)

The bootleg market seriously undermined the contractual primary distribution system: Bootleg dealers were undercutting contract dealers to such an extent that the latter were forced to free themselves from the obligation to maintain the full sales price by cancelling their agreements with their underwriters. As one informed commentator described the situation:

> "Authorized dealers, bound by contract to offer shares only at the public offering price described in the prospectus, were unable to meet the lower prices of their non-contract competitors by reducing sales charges. This difficulty apparently led to the cancellation of many selling agreements and resulted in increasing numbers of dealers leaving the field. It has been contended that, if the 'bootleg' market had been permitted to continue, contractual distribution systems would not have been able to survive. . . ." (Footnote omitted.)[21]

The bootleg market endangered not only the contractual distribution system, but also the viability of the funds themselves. Since the funds had to redeem shares continually, fresh cash from the purchase of newly issued shares was necessary to meet redemptions; otherwise the funds would be forced to liquidate securities, sometimes at

[21] Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940*, 37 U. Det. L.J. 369, 371-372 (1960). Mr. Greene is a former Assistant Director of the SEC's Division of Corporate Regulation.

a loss, in order to meet redemptions. The major source of cash to honor redemptions was the sale of fresh shares through the primary distribution system.[22] The bootleg market threatened to curtail this needed cash flow.[23]

The price-cutting secondary market in fund shares, thus depicted and presented to Congress by the SEC in 1940, constituted a grave threat to the industry's continued viability, which the funds attempted to counteract with private contractual measures which either confined sales to the primary distribution system or required that all sales be made at the published selling price.[24]

Congressional Response through the 1940 Act

Sections 22(d) and 22(f) of the 1940 Act, as ultimately enacted, were the product of SEC and industry collaboration, intended to counteract the ruinous competition of this secondary bootleg market. Whether the bootleg market was in fact a menace is not important. What is important is that it was so regarded in 1940, and the only relevant question is: What did Congress intend be done about it and by whom.

The Congressional response took several forms. In § 22(d), Congress required *all* dealers (not merely those under contract to the funds) to maintain the public offering price in sales to the public. This eliminated the price competition among dealers existing in 1940 and served to pro-

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[22] *Public Policy Report* at 202; see also *Special Study*, Part 2, at 95-97.

[23] Greene, *op. cit. supra*, at 372.

[24] *Investment Trust Study* at 860-871; statements of SEC Chairman Manuel E. Cohen before the House and Senate Committees considering amendments to the 1940 Act in *1967 House Hearings*, 59; *1967 Senate Hearings*, 151.

tect the primary distribution system from the incursions of the bootleg market.

In § 22(f), Congress recognized the right of mutual funds, as added protection against secondary market price-cutting, to restrict transferability of their shares while at the same time granting the SEC power to control these restrictions by rule or regulation. And throughout the Act the SEC was given broad, pervasive regulatory power to deal with all aspects of the mutual fund industry, particularly problems arising from the pricing and distribution of fund shares.

Since Congress in one instance mandates (§ 22(d)) and in the other sanctions (§ 22(f)) industry measures designed to prohibit or limit the very same secondary market competition which the appellant would require by judicial decree, it follows that Congress has by necessary implication immunized the pricing and distribution of mutual fund shares from antitrust law application. As the District Court held:

> ". . . the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act." (Opinion below, App. p. 345.)

Summary of Argument

The statutory plan for the sale and distribution of mutual fund shares established by Congress in the 1940 Act, and the implementation of that plan by the SEC as its authorized administrator, are incompatible with the imposition of civil or criminal antitrust liability under the Sherman Act for long-continued practices which are neither

contrary to the 1940 Act nor against SEC regulation under that statute.

Section 22(d) indisputably immunizes price fixing in the sale of shares in the primary distribution system; and it necessarily implies Congressional opposition to price competition in a secondary market endangering the integrity of that system.

In furtherance of this Congressional policy, Congress in § 22(f) recognized and gave its sanction to the right of mutual funds to check secondary market competition through dealer agreements reported to the SEC and not contravening SEC rule or regulation.

In accordance with this statutory structure, it has from the very beginning been the responsibility and function of the SEC to oversee industry conditions, to implement the 1940 Act, and to accomplish itself or recommend for Congressional approval or disapproval proposals for changes in the non-competitive system originated and maintained by the 1940 Act.

This Congress-SEC collaboration is presently in progress, as it has been in the past, regarding the advisability of permitting competition in the secondary dealer and brokerage markets. The precipitous intrusion of this litigation by the Department of Justice into the legislative-administrative process would inevitably result in a confrontation of conflicting economic philosophies and a clash of incompatible regimes, causing disruptive havoc in a well ordered and carefully regulated industry.

ARGUMENT

The Legislative and Administrative System Established by Congress for the Sale and Distribution of Mutual Fund Shares Precludes Antitrust Attack on the Alleged Restrictions on a Secondary Market.

In 1940, Congress established a mutual fund distribution system and placed it under the supervision and control of the SEC and NASD. Thus, regulation of sales loads—the target of appellant here—is vested in the NASD under § 22(b) of the 1940 Act. Section 22(c) empowers the SEC to approve or disapprove such NASD rules.[25] In § 22(d), Congress fixed the prices at which dealers must sell shares, and in § 22(f) it sanctioned restrictions on transferability and negotiability.

In addition to § 22, the SEC is granted broad powers by other sections of the 1940 Act. Section 6(c) empowers the SEC to "exempt any person, security, or transaction . . . from any provision" of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act.[26] 15 U.S.C. § 80a-6(c). And § 38 clothes the SEC with "authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate

[25] As noted above, the SEC-NASD rule-making power over sales loads is one of the subjects of the 1974 Report, and administrative action is presently being taken.

[26] The Antitrust Division took the position before the SEC that the SEC's powers under § 6(c) were so pervasive as to enable the SEC to nullify the effects of § 22(d) without even waiting for repeal (1974 Report at 70).

to the exercise of the powers conferred upon the Commission elsewhere" in the Act. 15 U.S.C. § 80a-38.[27]

Indeed, as the letter transmitting the 1974 Report to Congress states, "No issuer of securities is subject to more detailed regulation than a mutual fund." This "detailed regulation," including strict control over the marketing and distribution of mutual fund shares, is so pervasive as to raise the presumption of an exemption from the antitrust laws. See, *e.g., Hughes Tool Company* v. *Trans World Airlines,* 409 U.S. 363 (1973); *Pan American World Airways* v. *United States,* 371 U.S. 296 (1963); *Baum* v. *Investors Diversified Services, Inc.,* 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd* 409 F.2d 872 (7th Cir. 1969).

The intent of Congress that the fund distribution system be maintained as it existed in 1940, subject only to the control of the SEC, finds greatest support in §§ 22(f) and 22(d) of the 1940 Act.

A. By Section 22(f) Congress Authorized the Alleged Secondary Market Restrictions Subject Only to SEC Disapproval.

Section 22(f) provides that restrictions on transferability and negotiability of shares are valid if disclosed to the SEC in the fund's registration statement and not in contravention of any SEC rule or regulation. The enactment of § 22(f), despite Congressional awareness of existing contractual inhibitions on secondary market competition,[28] evidences the intention that these limitations not

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[27] The SEC has in fact exercised its broad rule-making powers in connection with the pricing and distribution of mutual fund shares. See, *e.g.*, Investment Company Act Rules 22c-1, 22d-1 and 22d-2, 17 C.F.R. §§ 270.22c-1, 22d-1 and 22d-2.

[28] In fact, sales agreements contained such restrictions even before passage of the 1940 Act. *Investment Trust Study* at 860-71.

only *not* be eliminated, but that they be continued subject only to SEC regulation.

When first proposed in the SEC draft bill, the section, then numbered 22(d)(2), gave the SEC power to

> "*prohibit* . . . restrictions upon the transferability and negotiability of any redeemable security of which any registered investment company is the issuer."

In testimony in connection with this proposed section, David Schenker, Chief Counsel to the SEC, explained that the existing private restrictions on transferability to which the draft section referred were directed against the secondary "bootleg" market. As Mr. Schenker testified,

> "Now coming to subparagraph (2) of (d) [now § 22(f)], it just says that the Commission shall have the right to make rules and regulations with respect to any restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.
>
> "There are some companies that have a provision in their certificates to the effect that you cannot sell the certificate to anybody else, and the only way you can sell it is . . . back to the company. That is a technical problem. *It presents a whole problem which they call the bootleg market.*"[29]

Confronted with a secondary market threat, on the one hand, and, on the other, the private restrictions designed to combat that threat, the SEC and the industry in redrafting § 22, and Congress in passing the section, had several choices: (1) the restrictions could have been abolished outright; (2) the statute need not have dealt with the restrictions at all, leaving them vulnerable to the

[29] Hearings on S. 3580 before Subcomm. of the Senate Comm. on Banking & Currency, 76th Cong., 3d Sess. at 292 (1940).

antitrust laws; (3) Congress could have provided that no restriction should be valid unless specifically approved in advance by SEC rule, thereby establishing *a priori* standards of validity; or (4) § 22(d)(2) could have been enacted as originally introduced, giving the SEC merely power to prohibit all these restrictions, but providing nothing regarding their validity.

Congress adopted none of these alternatives. In § 22(f), it established SEC control, but with the important qualification that a restriction was to be valid if disclosed in a fund's registration statement, unless "in contravention of such rules and regulations as the Commission may prescribe." Congress thus acknowledged the funds' right to continue their existing contractual restrictions on competition, subject only to SEC contravening rule or regulation. As the Court below held, in enacting § 22(f),

> "Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications." (App., p. 354)

Appellant searches in vain for any other or different meaning in § 22(f). Directly contrary to the legislative development of § 22(f), appellant distorts its provisions to require that *before* a restriction may be valid it must conform to a *pre-existing* SEC rule or regulation specifically validating it; and since admittedly there is no such rule or regulation, none of the restrictions here involved has validity (Appellant's Brief, p. 44). However, the language and legislative history of the section just recounted establish a directly contrary intention: *the restrictions are valid unless an SEC rule or regulation invalidates them.*

It is also contended that the restrictions permitted by § 22(f) are those imposed directly by funds—not, as here alleged, by underwriters in agreements with dealers (Appellant's Brief, p. 43). But this ignores the statutory requirement that a fund must use an underwriter to distribute its shares.[30] Additionally the agreements between fund and underwriter require fund approval of the dealer agreements covering sales to the public, to be evidenced by the filing of the dealer agreements by the fund with the SEC.[31] In reality, therefore, restrictions imposed on transferability and negotiability of fund shares originate with the fund.

Indeed, the 1974 Report recognizes that § 22(f) is meant to cover limitations on transferability such as those under attack here. In discussing the abolition of contractual restrictions on a secondary brokerage market, the Report notes:

> "In addition, if it appeared that funds were attempting to defeat the intent of such an NASD rule [prohibiting brokerage restrictions] by restricting transferability of their shares in a secondary brokered market, we would recommend that the Commission propose a rule under Section 22(f) of the Act to prohibit such restrictions."[32]

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[30] 15 U.S.C. § 80a-12(b).

[31] In point of fact, the SEC instructions for Form N8B-1, the Registration Statement filed by a fund pursuant to § 8 of the 1940 Act, require attachment of "all agreements between principal underwriters and dealers," and the instructions for Form S-5 filed pursuant to the Securities Act of 1933 in connection with current distribution of fund shares require the same submission.

[32] 1974 Report at 105; See also *Proposed Amendments to the Rules of Fair Practice of the NASD*, 9 SEC 38, 44-45 (1941), where the SEC noted that an NASD rule requiring dealers to become record owners of shares they redeem was a "restriction on transferability," even though the rule did not affect the manner of transferability but only the dealers' conduct, similar to the restrictions challenged in this case.

It should be noted that, prior to this action, the Department of Justice recognized the existence of that power in the SEC under § 22(f). In referring to the suggestion made in the *1972 Staff Study* that, even if § 22(d) were repealed, captive funds would be able to forestall a secondary market by making it hard for dealers to redeem shares, thereby creating a risk that it would be difficult to dispose of shares not obtained through the fund, the Justice Department stated:

> "However, the Commission could eliminate such difficulties, if they arise, by promulgating regulations prohibiting unreasonable restrictions on transferability pursuant to § 22(f) of the Investment Company Act."[33]

This concession of SEC power under § 22(f) was repeated by Mr. Daniel Hunter, of counsel to the appellant below and on this appeal, in testimony before the SEC on the impact of the possible repeal of § 22(d).[34] Moreover, as thus construed by the appellant, § 22(f) clothes the SEC with such plenary power as would enable it to abolish or continue these restrictions in its discretion, even if § 22(d) were repealed.

Finally, appellant errs most conspicuously in asserting that appellees rely on the SEC's "administrative silence" regarding these restrictions (Appellant's Brief, p. 50). The SEC has been anything but silent. The discussion of these restrictions in the *Investment Trust Study* has previously been noted (p. 19, *supra*). The SEC has spoken out repeatedly since then. In the documents submitted by appel-

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[33] *1973 SEC Hearings*, Comments of the United States Department of Justice, pp. 13-14.

[34] *1973 SEC Hearings* at 2089-2090.

lant as exhibits below (GX. 6; App. p. 251), the SEC staff recognized in a 1959 memorandum regarding an NASD rule, which would have prohibited contract dealers from engaging in a secondary dealer market,

> "that selling group agreements could and often did bar such transactions."

Thus there was official recognition 15 years ago that private agreements could and did impose restrictions on a secondary dealer market, of which the SEC was fully aware.

The SEC has repeatedly broken "silence" regarding the restrictions questioned here, evidencing its complete awareness, yet non-disapproval of them.[35] As late as 1973, in SEC correspondence with a principal underwriter, submitted as an exhibit by the appellant below (GX. 5; App. p. 247), the Chief Counsel of the Division of Investment Management Regulation stated that "the [1940] Act does not prohibit a broker-dealer from acting as an agent with respect to a client," but continued:

> "It is not clear to me whether or not paragraph 3 of your Dealer Agreement prohibits such broker activity, but I assume that, if it does, *you would waive the prohibition.*"

Hence, the SEC not only recognizes that contractual restrictions exist, but acknowledges their propriety, since one can only "waive" an "existing right."[36]

Clearly then, in § 22(f) Congress validated restrictions on the secondary markets existing in 1940 substantially

[35] *Special Study*, Part 4, p. 98; *In re First Multifund of America, Inc.*, CCH F. Sec. L. Rep. ¶ 78,209 at p. 80602 n (1971); *Matter of Mutual Funds Advisory, Inc.*, Investment Company Act Release No. 6932 at 6, 7 (1972); *1972 Staff Study* at 24.

[36] *Van Bourg* v. *Nitze*, 388 F.2d 557, 565 (D.C. Cir. 1967); accord: *United States* v. *Robinson*, 459 F.2d 1164, 1168, (D.C. Cir. 1972), quoting *Johnson* v. *Zerbst*, 304 U.S. 458, 464 (1938).

identical with those now challenged in 1975 as antitrust violations, provided only that they are disclosed to, and not disapproved by, the SEC.

The 1974 Report makes clear the SEC's purpose to exercise its powers under § 22(f) to disapprove limitations on competition in a secondary brokered market, but to permit their continuance in a secondary dealer market. In view of the existence and exercise of that administrative power, the instant attempt to procure an antitrust injunction presents the imminent danger envisioned by this Court in *Pan American World Airways, Inc., supra,* at 310:

> "If the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide."

B. By Section 22(d) Congress Intended to Protect the Primary Distribution System from Competition in a Secondary Market.

Section 22(d) requires "dealers" to sell mutual fund shares at the "public offering price", including the sales load. Enacted against the background of the bootleg market maintained by dealers undercutting the full sales price, § 22(d) eliminated that price competition by taking away the right of any dealer to undercut the primary distribution system.

Appellant, however, claims that § 22(d) had only the narrow goals of eliminating dilution, insider trading and riskless trading. Yet the broad sweep of the section discountenances this attempt so to limit its scope. As one industry member wrote at the time the Act was under Congressional consideration,

> "The problem of dilution and riskless trading is inherent in the existing pricing methods of selling open-end shares. * * * This practice is aggravated

when the dealers manage to sell back their shares immediately to the company at a profit to themselves, obviously at the expense of the trust and without risk. *There can be no doubt that this represents an unwholesome condition, but Section 22(d) is not needed to eliminate it.* It is already covered by Section 22(a), which is designed to eliminate riskless trading and dilution.

* * *

"*If the provision* [§ *22(d)*] *will achieve anything at all—and we think it was designed for this purpose —it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly.*" [37]

Numerous pronouncements of the SEC since the passage of the statute support the view that Congress intended § 22(d) to have a broad impact on the price-cutting secondary market.[38] The discussion of § 22(d) before Congress in 1967, when amendment was under consideration, also presented the view that § 22(d) precluded all price competition. Thus SEC Chairman Cohen testified before Congress in 1967:

"Mutual fund sales charges are not free market prices determined by free competition. They are

[37] "Memorandum covering S. 4108" from Asiel & Co., to the NASD (1940) (App. pp. 314-315). This memorandum was also presented to the SEC.

[38] *Matters of Investors Diversified Service, Inc., et al.*, Investment Company Act Release No. 3015 (April 15, 1960); *Matter of Notice of Proposal to Adopt Rule N-22D-1*, Investment Company Release No. 2718 (May 28, 1958); *Matter of Adoption of Rule N-22D-1*, Investment Company Act Release No. 2798 (December 2, 1958); *Matter of Spiro Sideris, d/b/a Olympic Insurance and Securities Agency*, Securities Exchange Act Release 3816 (February 13, 1970); *Matter of Axe-Houghton Fund, Inc.*, 25 SEC 133, 139 (1947); *Mutual Funds Advisory, supra*, Brief submitted by SEC Division of Corporate Regulation, p. 12; See also, *Greene, op. cit. supra*, at 371.

> fixed under an exemption from the antitrust laws found in Section 22(d) of the Investment Company Act.'"[39]

And the Antitrust Division of the Justice Department reluctantly agreed:

> "It is true that Congress, in originally enacting the 'fixed price' provisions of Section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws."[40]

Hence, Congress, in refusing to amend § 22(d) in 1970, acted on the basis that the section effectively precluded price competition. Appellant cites no testimony or other evidence showing that Congress was apprised that any price competition, from a "brokerage market" or otherwise, was permissible under § 22(d). The claim is therefore completely unwarranted that Congress "favors transactions in a secondary market at competitively fixed prices" (Appellant's Brief, p. 40). Section 22(d) was intended to eliminate price competition, not favor it.

Why, then, is it contended in this case that by using the word "dealer" in § 22(d), Congress did not mean to eliminate a *brokerage* market? It is, we believe, because the Department of Justice continues to question the wisdom of the Congressional decision that mutual funds should be free from price competition in a secondary market. In an effort to negate that decision by judicial decree, the Department claims discovery of a "loophole" in the statute, *i.e.*, if "dealer" is defined narrowly, § 22(d) can be so read

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[39] *1967 House Hearings* at 109.

[40] Letter from Deputy Attorney General Warren Christopher to Harley O. Staggers, Chairman, House Committee on Interstate and Foreign Commerce, October 18, 1967, *1967 House Hearings* at 21.

as to permit competition in a secondary brokerage market (Appellant's Brief, pp. 21-22). But one must disregard history to argue that Congress knowingly and intentionally created such an escape hatch in light of its clearly expressed contrary intention to insure the exclusion of this very same price competition. Throughout the legislative and administrative history of the Act, the words "broker", "agent" and "dealer" are used interchangeably in Congressional hearings by witnesses and legislators alike,[41] and the ultimate message from Congress is clear—*all* price competition should be, and is, precluded by § 22(d).

It should be noted that the appellant's interpretations of both §§ 22(d) and 22(f), when taken together, lead to the incongruous conclusion that no section of the 1940 Act had any connection with the bootleg market problem. Yet, it is not disputed that the bootleg market existed in 1940. That it was regarded by the SEC and the industry alike as a danger to the primary distribution system is also indisputable. In the face of these facts, it is incredible that the coauthors of the 1940 Act would nevertheless fail to provide in their proposed legislation any remedy for the problem they both viewed with such concern.

C. Whether the Secondary Markets Sought by the Appellant Would Serve the Public and Industry Interests is a Legislative and Administrative, and Not a Judicial Issue.

Appellant argues that secondary market price competition is not inimical to the maintenance of the primary distribution system (Appellant's Brief, pp. 33-35). Be that

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[41] See, *e.g.*, statements of Senator Mondale, *1967 Senate Hearings* at 275, 769 (§ 22(d) acts upon "agents"); testimony of Paul Samuelson, *1967 Senate Hearings* at 348 (§ 22(d) acts upon "brokers"); testimony of SEC Chairman Cohen, *1967 House Hearings* at 711 (§ 22(d) acts upon "broker-dealers").

as it may, it is clear that in 1940 and again in 1967 Congress, the SEC and the industry all proceeded on the assumption that this price competition indeed posed a threat to the primary distribution system. Moreover, whether that system should be altered is peculiarly a matter for administrative and legislative determination.

Years of study and extensive hearings have gone into the completion of the 1974 Report. During this period, the question as to the advisability of introducing price competition into the marketing of mutual fund shares has been given primary and prolonged consideration. The views expressed regarding the question have been many and varied.[42] The final result of these labors is the recommendation of the 1974 Report that limited and experimental competition in the sale of shares in a secondary *brokerage* market warrants some risks to the primary distribution system. Even so, the SEC still adheres to its cautionary approach, stating:

> "steps should be taken to prevent a secondary brokered market from having an adverse impact on the primary distribution system." (p. 109)

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[42] For example, SEC witnesses before Congress have, in the past, seriously questioned the notion of price competition. In testifying on the possible repeal of § 22(d) in 1967, SEC Chairman Cohen stated that

> "It may be a valid argument that to introduce a competitive regime in this industry would be to break too sharply with its established ways of doing business." (*1967 House Hearings* at 113.)

And in 1969, SEC Commissioner Owens told the Senate Committee on Banking & Currency that

> "We don't know what condition will result in the market place if 22(d) is repealed.
>
> "We are told that wildcatting and price cutting will be ruinous to the industry. It well might be." (*1969 Senate Hearings* at 24-5.)

However, as to retail price competition in both the primary and secondary brokerage dealer markets, the Report concludes:

> "We believe that mutual fund shares could not be sold effectively under a system of full retail price competition in the present distribution environment; nor is it likely that the public would significantly benefit from an attempt to institute such a system without an appropriate foundation having first been laid for it." (p. 80)

The 1974 Report recommends a panoply of administrative and legislative action for the tentative and gradual introduction of price competition into the alien field of mutual fund marketing. It would be unwarranted and unwise indeed to permit the present antitrust litigation to intrude upon and disrupt the administrative and legislative process now in progress.

D. The First Count of the Complaint Alleging Improper "Collusive Action" was Properly Dismissed.

The decision below dismissed claims of two different alleged restraints—vertical restraints by the various fund, underwriter and dealer appellees (Counts II-VII of the Complaint) and alleged horizontal "collusive action" restraints by the NASD and all the other appellees (Complaint, Count I). The appellant urges that, even assuming the counts alleging vertical restraints were properly dismissed, the allegations of collusive horizontal action must stand (Appellant's Brief, p. 63).

In this connection, appellant's assertion that the motion below could not be granted unless immunity could be found "for virtually any set of facts relating to suppression of competition in secondary markets that the government might prove" (Appellant's Brief, p. 18) ignores both the

language of the Complaint and the nature of the proceedings below.

It is admitted that "appellees appended exhibits to their supporting memoranda [43] and the government filed an affidavit describing certain attached documents *in support of the allegations in its complaint.*" Admittedly, these affidavits and documentary exhibits were accepted without objection by the lower court (Appellant's Brief, p. 16, n. 14).

FRCP 12(b)(6), under which the dismissal motions originated, provides that if on a motion to dismiss under subdivision (6), "matters outside the pleading are presented to and not excluded by the court, the motion *shall* be treated as one for summary judgment and disposed of as provided in Rule 56." Hence the motions to dismiss the complaint below *required* treatment as motions for summary judgment. But "the very mission of the summary judgment procedure is to pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial." [44]

Moreover, on a motion for summary judgment, "an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him." FRCP Rule 56(e)

Appellant, as the record shows, recognized and attempted to meet this burden by filing Mr. Hunter's affida-

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[43] Actually, Fidelity filed an affidavit by its Secretary, Caleb Loring, with attached evidentiary exhibits showing Fidelity's compliance with the filing requirements of § 22(f). (App. pp. 155-56)

[44] 1963 Advisory Committee Note to FRCP Rule 56(e).

vit [45] and annexing thereto some thirty exhibits in support of the Complaint, including the allegations of collusive activity on the part of the appellees (Hunter Affidavit and Exhibits, App. pp. 230-305). Appellees did not deny the authenticity of these exhibits, but rather relied on their content as evidence conclusively showing the absence of any issue of fact as to the alleged conspiracy.

Thus in evaluating the charges of "collusive action", the proper inquiry is not into "any set of facts" imaginable that the appellant might prove, but rather into the sufficiency of the specific allegations of the Complaint, as amplified by the supporting Hunter Affidavit and documentary exhibits. Neither the allegations nor the exhibits can withstand such analysis.

The collusive action charged is detailed in Paragraph 17 of the Complaint. Subparagraphs 17(a) and (b) allege that the NASD has "established and maintained rules" restricting a secondary market. (App. p. 9) However, since appellant has now disclaimed attacking NASD rules (Appellant's Brief, p. 51), these allegations have become moot. Subparagraph 17(c) alleges that the NASD has "induced member principal underwriters to include restrictive provisions in their sales agreements." To buttress this allegation, the appellant submitted documents (GX 6; App. p. 253) referring to a 1959 proposal to amend NASD rules to preclude certain secondary market dealer activity. In its discussion of this incident in its brief, the appellant argues that the documents show the SEC opposed such a rule as not supported by the 1940 Act (Appellant's Brief, p. 61). But the appellant omits the fact, shown by the very same documents, that the SEC staff,

[45] The Hunter Affidavit clearly does more than merely identify documents (Appellant's Brief, p. 14n), but argues the appellant's position and was intended to support the Complaint's allegations. See, *e.g.*, pars. 8 and 9, App. p. 231.

in consultation with the NASD, suggested that the dealer agreements could be so written as to accomplish the same goal. The NASD circulated this staff suggestion among its members, including the appellees. Thus the appellant's own documentary evidence disproves its allegations of "collusive" action, since such action, if taken, merely followed the suggestion of the SEC itself. There is no statement or even intimation by the appellant that it possesses any additional facts to support the allegations of Paragraph 17(c) other than this 1959 incident.

Finally, subparagraphs 17(d) and (e) allege in vague terms that the appellees disseminated misleading marketing information and suppressed quotations of market prices. (App. p. 9) Appellant did not attempt to support or even specify these charges by concrete facts, documents or affidavit. In any event, the publication of market quotations and the dissemination of other market information is under the constant and close supervision of both the NASD and SEC, as the Court may judicially notice, and falls under the regulatory authority and control of these bodies. See, *e.g.*, *§ 15(c)(2), Securities Exchange Act of 1934.*

Appellant assumes arguendo that vertical restrictions on the distribution of a fund's shares may be permitted by the SEC under § 22(f), but contends that "a horizontal conspiracy" among the appellees "to impose restrictive provisions" would be illegal, citing *Georgia* v. *Pennsylvania R. Co.*, 324 U.S. 439 (1945). That case is inapposite. It held that a conspiracy among railroads to fix discriminatory and coercive rates in violation of the antitrust laws may be enjoined even though the rates themselves have not yet been passed upon by the Interstate Commerce Commission. Indeed it was intimated that an injunction against a rate-fixing conspiracy might issue at the instance of the United States even after the rates have received Commission ap-

proval. That is to say, while the Interstate Commerce Commision had jurisdiction to determine that the rates were reasonable in amount, it was without power to deal with the alleged private antitrust conspiracy fixing those rates. As Justice Douglas wrote for the majority of five:

> ". . . Congress has not given the Commission comparable authority to remove rate-fixing combinations from the prohibitions contained in the antitrust laws. It has not placed these combinations under the control and supervision of the Commission. Nor has it empowered the Commission to proceed against such combinations through cease and desist orders, or otherwise to put an end to their activities." (p. 456)

This certainly cannot be said of the SEC's authority under the 1940 Act. It has the power to enforce the mandatory price-maintenance provisions of § 22(d), and to grant exemptions from that section (§ 6(c)); and it may promulgate rules and regulations to make any provisions of the Act more effective in the public interest (§ 38). Under § 22(f), as we have seen, it may in its discretion permit or prohibit or modify restrictions on the transferability and negotiability of shares—classic antitrust restraints on trade. In addition, the NASD, which is itself immunized from the antitrust laws under the Maloney Act, is empowered to insure the reasonableness of the sales loads charged to investors (§ 22(b)).

Georgia v. *Pennsylvania R. Co.* therefore is not authority for the application of the Sherman Act to the "horizontal" conspiracy here alleged, just as it is impossible to find the existence of such a conspiracy under the facts alleged and the documents submitted to support the instant Complaint.

E. The Practices Challenged Here are Immunized From Antitrust Attack by the Pervasive Regulatory Power of the SEC.

That the powers of the SEC in the premises are pervasive can hardly be denied. The appellant, however, erroneously contends that a mere grant of pervasive regulatory power without specific antitrust exemption is not sufficient to immunize regulated conduct from antitrust liability (Appellant's Brief, p. 56). This view, however, is contrary to the pronouncements of this Court. See, *e.g., Pan American World Airways, Inc., supra*; *Hughes Tool Co.* v. *Trans World Airlines, supra*; *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963). The test, as declared in the *Philadelphia National Bank* case, is whether the regulatory scheme "is so comprehensive that enforcement of the antitrust laws would either be unnecessary, in light of the completeness of the regulatory structure, or disruptive of that structure." (p. 352) In this case the regulatory structure is complete, and the inevitable interference with that structure by an antitrust decree would clearly be disruptive.

Appellant contends further that in order to find antitrust immunity:

> "(1) the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers; (2) the regulatory scheme must require the supervising agency to focus upon competitive considerations in exercising those powers; and (3) the agency must have express statutory authority to immunize the conduct in question from the antitrust laws." (Appellant's Brief, p. 56)

The first of the appellant's tests is clearly met in this case; the other two are not required for limited antitrust immunity.

First. The alleged inhibitions upon competition in a secondary market which are challenged here "are the precise subject of a proceeding subject to the regulatory agency's remedial powers" long exercised and culminating in the 1974 Report.

Second. It is not necessary, as the appellant contends, that the regulatory scheme require competitive considerations to be taken into account by the supervising agency. But even if it were, it cannot be said that the SEC is not required to consider competitive criteria when the price-fixing mandated by § 22(d), the reasonableness of the sales load and the propriety of restraints on the transferability of shares, all necessarily involve competitive considerations in the exercise of the SEC's powers.

Third. The SEC does in fact have "express statutory authority to immunize" the restrictions in question from the antitrust laws under § 22(f). Even assuming those restrictions would otherwise be violations of the Sherman Act, the SEC may immunize them from the antitrust laws by its decision not to adopt any contravening rule or regulation.

In any event, the SEC is expressly required by the Maloney Act to take competition into account when reviewing NASD rules. 15 U.S.C. § 78o-3(b)(8) The 1940 Act itself is intended to promote the "public interest"[46] and it is this mandate which controls the SEC's regulatory action regarding competitive factors in the industry.

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[46] 1940 Act, § 1. In addition, by Section 22(f) the SEC is required to regulate transferability restrictions "in the interests of the holders" of a fund's shares. See, also, §§ 6(c), 38.

As this Court stated in the *Pan American* case, *supra*:

> "It would be strange, indeed, if a division of territories or an allocation of routes which met the requirements of the 'public interest' as defined in § 2 [of the Federal Aviation Act] were held to be antitrust violations." (p. 309)

So here, it would be "strange, indeed" if anticompetitive restrictions, monitored and not disapproved by the SEC in the "public interest", were held to be violative of the antitrust laws.

In *Pan American, supra,* the Court held that Pan American was immunized from the antitrust laws for acts taken subject to the approval of the Civil Aeronautics Board under § 411 of the Federal Aviation Act. Even though other sections of that statute granted express antitrust immunity and despite the absence of such exemptive language in § 411, the Court nevertheless found the pervasive powers of the Civil Aeronautics Board over the challenged conduct were sufficient for immunity from the antitrust laws.

This view was well expressed in another connection in the recent case of *Gordon* v. *New York Stock Exchange,* 498 F.2d 1303 (2d Cir. 1974), *certiorari granted,* —— U.S. ——; 42 L.Ed. 2d 291. There immunity from the antitrust laws was found for the fixing of stock exchange brokerage commission rates in view of the SEC's broad regulatory powers over them. The court held that the regulatory aims promoted by Congress in delegating power to the SEC over the commission rate structure would be frustrated by "inconsistent standards announced contemporaneously by courts and Commission." (p. 1306) Here, appellant seeks precisely this contemporaneous misapplication of "inconsistent standards."

Conclusion

All phases of mutual fund marketing, especially the competitive aspect of sales of shares to the public, are and have continually been closely scrutinized and regulated by the SEC and the NASD under the 1940 Act. They have been the constant object of Congressional concern as well. Therefore, activities in this area may not be made the recipients of dispensations under the 1940 Act, as administered by the SEC, and at the same time be subjected to the interdictions of the Sherman Act, as misapplied by the Department of Justice in the case at bar.

The Judgment of the District Court Should be Affirmed.

Respectfully submitted,

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Dated: New York, New York
January 20, 1975

No. 73-1701

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

UNITED STATES OF AMERICA, *Appellant*

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL., *Appellee*

On Appeal From the United States District Court For the District of Columbia

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BRIEF OF APPELLEE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

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BRIEF OF APPELLEE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

This is an appeal from a judgment dismissing a complaint which alleges violations of the Sherman Act in connection with the sale of securities of open-end management investment companies or mutual funds as they are called. The National Association of Securities Dealers, Inc. ("the NASD") was named as a defendant in the count of the complaint alleging a conspiracy and combination.

STATUTES INVOLVED

Pertinent provisions of Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3, and of Section 22 of the Investment Company Act, 15 U.S.C. 80a-22, are set out in Appendix A and Appendix B hereto, respectively.

QUESTION PRESENTED

Whether the Sherman Act reaches the hereinvolved activities of the NASD which relate to the primary distribution of mutual fund shares, and which are subject to a comprehensive statutory pattern of regulation and pervasive oversight by the Securities and Exchange Commission (1) under the Maloney Act that embodies its own measures for dealing with anticompetitive practices and provides for antitrust immunity, and (2) under the Investment Company Act that relies upon regulation rather than competition for determining sales charges to investors in the sale of mutual fund shares.

STATEMENT

The NASD is a creature of Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3, the so-called Maloney Act of 1938. It has regulatory responsibilities over the over-the-counter markets generally. In addition, the Investment Company Act of 1940, 15 U.S.C. 80a-1, *et. seq.*, vested the NASD with authority in connection with the pricing and sales charges for shares of mutual funds. The NASD currently has approximately 3200 members of whom about half are primarily engaged in the sale of mutual fund securities.[1]

A. The Maloney Act

The Maloney Act supplements the regulation of the over-the-counter markets by the Securities and Exchange Commission ("the Commission"). It provides a system of cooperative regulation of over-the-counter markets through voluntary associations of brokers and dealers. To spur membership, Section 15A (i) (1) provides that the rules of an association may provide that no member shall deal with

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[1] References will be made to pages of appellant's brief as "Br. " and to the Joint Appendix as "J.A. ". Italics appearing in quotations are not in the original and have been added.

a non-member except on the same terms, including price, as such member accords the general public. Section 25 of the NASD Rules of Fair Practice so provides.

The NASD is the only national securities association registered under Section 15A.[2] As such it is subject to a reticulated pattern of statutory regulation as well as comprehensive and continuous supervision by the Securities and Exchange Commission. For example, the rules of the NASD must satisfy prescribed statutory standards that, *inter alia,* deal with anti-competitive practices, and provision is made for antitrust immunity. Thus, Section 15A embodies an accommodation of the policies of the securities laws and those of the antitrust laws.

To qualify for registration, a national securities association must, under Section 15 (A) (e), satisfy the detailed requirements of Section 15A. These requirements are cast primarily in terms of what an association's rules must provide.

Section 15A (b) (8) is the focal point of the Maloney Act. It ". . . outlines the functions for the accomplishment of which registered securities associations are expected to accept responsibility."[3] This section provides:

> "An applicant association shall not be registered as a national securities association unless it appears to the Commission that—
>
> * * *
>
> "(8) the rules of the association are designed to prevent fradulent and manipulative acts and practices, to promote just and equitable principles of trade, to

[2] The NASD, which was incorporated in Delaware on July 18, 1939, became registered under Section 15A of the Securities Exchange Act on August 7, 1939. *National Association of Securities Dealers, Inc.,* 5 S.E.C. 627 (1939).

[3] S. Rep. No. 1455, p. 7, H. Rep. No. 2307, p. 7, both accompanying S.3255, 75th Cong. 3d Sess. (1938) which contains Section 15A. The provision was then Section 15A (b) (7); it was renumbered as a result of other amendments in 1964.

provide safeguards against unreasonable profits or unreasonable rates of commission or other charges, and, in general, to protect investors and the public interest, and *to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers,* to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges."

Section 15A contains a web of provisions to assure Commission jurisdiction and continuous supervision of the rules of an association. Section 15A establishes the Commission as the forum for treating with these rules. Thus, as already pointed out, under Section 15A (e), an association may not be registered unless the Commission is satisfied that the association has adopted rules required by Section 15A. Next, under Section 15A (j), any change in or addition to an association's rules does not become effective until the Commission is afforded an opportunity for scrutiny, and the Commission is obligated to disapprove a change or addition unless it is "consistent with the requirements" of Section 15A (b). Furthermore, Section 15A (k) (1) authorizes the Commission to abrogate an existing association rule "where necessary or appropriate to assure fair dealing by the members of such association . . . or otherwise to protect investors or to effectuate the purposes of this title."[4] The Commission is also authorized under Section 15A (k) (2) to alter or supplement association rules in certain areas. Again, under Section 15A (h) (1), which provides for Commission review of disciplinary action taken by an association, the Commission must consider the application and interpretation of the association's rules that are involved.

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[4] The Commission has invoked this authority to abrogate an interpretation by the NASD of one of its rules. *National Association of Securities Dealers, Inc.*, Securities Exchange Act Release No. 9682 (June 7, 1972), *aff'd, N.A.S.D.* v. *S.E.C.*, 486 F. 2d 1314 (C.A.D.C.).

Other provisions of Section 15A, many of which also include rulemaking power, relate to scope of membership and character of the association[5]; disqualifications for membership[6]; training and experience of members and their associates[7]; representation and dues[8]; association disciplinary action against members and their associates,[9] and Commission review thereof[10]; withdrawal of an association from registration[11]; affiliated securities associations (of which there are none)[12]; and Commission disciplinary action against members or their associates, and against the association itself as well as its management.[13]

Finally, as the Commission has stated, since "Congress obviously did not intend to subject the NASD to liability under the antitrust laws for performing a function authorized by statute",[14] Section 15A (n) provides:

> "If any provision of this section is in conflict with any provision of any law of the United States in force on

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[5] Section 15A (b) (1), (2), and (3), 15 U.S.C. 78o-3 (b) (1), (2) and (3).

[6] Section 15A (b) (3) and (4), 15 U.S.C. §78o-3 (b) (3) and (4).

[7] Section 15A (b) (5), 15 U.S.C. §78o-3 (b) (5).

[8] Section 15A (b) (6) and (7), 15 U.S.C. §78o-3 (b) (6) and (7).

[9] Section 15A (b) (9) and (10), 15 U.S.C. §78o-3 (b) (9) and 10.

[10] Section 15A (g) and (h), 15 U.S.C. §78o-3 (g) and (h).

[11] Section 15A (f), 15 U.S.C. §78o-3 (f).

[12] Section 15A (c) and 15A (b) (11), 15 U.S.C. §78o-3 (c) and (b) (11).

[13] Section 15A (l), 15 U.S.C. §78o-3 (l).

[14] 1967 Senate Hearings, note 51, *infra*, at p. 123.

the date this section takes effect, the provision of this section shall prevail."[15]

In addition, as discussed below, the Investment Company Act grants an association rule making power in connection with the pricing and sales charges for mutual fund shares. This power, in addition to meeting the applicable standards of that statute, must be exercised in accordance with and subject to Section 15A.[16]

B. The Investment Company Act and the Sale of Mutual Fund Shares

The Act provides for thoroughgoing regulation of all aspects of the activities and operations of all types of investment companies. Section 22, *inter alia*, deals specifically with the sale and redemption of mutual fund shares.

A mutual fund is essentially a managed portfolio of securities. It is characterized by the fact that it issues a redeemable common stock under an obligation to pay the holder his proportionate share of the market value of the fund's net assets.[17] In effect, this redemption right provides

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[15] In *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 227, n. 60 (1950), this Court stated:

> ". . . [T]he typical method adopted by Congress when it has lifted the ban of the Sherman Act is the scrutiny and approval of the designated public representatives . . . And see the Maloney Act (§15A of the Securities Exchange Act of 1934; 52 Stat. 1070) providing for the formation of associations of brokers and dealers with the approval of the Securities and Exchange Commission and establishing continuous supervision by the Commission over specified activities of such associations."

See also *International Association of Machinists* v. *Street*, 367 U.S. 740, 809-10, n. 16 (dissenting opinion).

[16] See note 36, *infra*.

[17] Sections 2 (a) (32), 5 (a) (1) and 22 (e) of the Act, 15 U.S.C. 80a-2 (a) (32), 5 (a) (1) and 22 (e).

a ready "market" for a selling shareholder.[18] Because of the redeemability feature, mutual funds generally make a continuous offering or a primary distribution of their common stock in order to prevent their assets from shrinking. The offering price per share, which is described in the fund's prospectus, consists of the net asset value per share, which is computed at least once a day, plus a sales charge or "sales load"[19] fixed by the principal underwriter in the case of the type of funds here under consideration.

Section 22 embodies a unique regulatory pattern that encompasses the price at which mutual fund shares are to be sold both in the primary distribution and thereafter. It is based on the Maloney Act's design of cooperative regulation. As more fully described below, Section 22 authorizes the NASD to adopt rules relating to the computation of the net asset value and sales load components making up the public offering price. These rules must be passed upon by the Commission. Provision is made for antitrust immunity. The Commission exercises continuing oversight with respect to the NASD rules. It may alter or supplement NASD rules and also adopt its own rules, which may supersede NASD rules. The public offering price described in the prospectus is sustained by a statutory retail price maintenance provision.

To implement Section 22, the NASD has adopted one rule specifically dealing with mutual funds, Section 26 of its Rules of Fair Practice, pertinent text of which is set forth in Appendix C. The rule relates to the primary distribution and redemption of mutual fund shares. The rule and its amendments have been passed upon by the Com-

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[18] *United States* v. *Cartwright,* 411 U.S. 546, 549, 557.

[19] Section 2 (a) (35) of the Act, 15 U.S.C. 80a-2 (a) (35).

mission and tested against the applicable standards of Section 22 and Section 15A (b) (8) of the Maloney Act.[20]

The primary distribution by which mutual funds sell their shares to investors has been basically as follows, both before and since the passage of the Act: The mutual fund by contract grants the exclusive right to purchase shares from the fund to a principal underwriter, who generally acts only as a wholesaler, and leaves the retailing to dealers, who enter into a sales agreement with the underwriter. The underwriter may enter into contracts with hundreds of dealers; dealers, in turn, may enter into sales agreements with any number of underwriters. The principal underwriter and the retail dealer divide the sales load component included in the public offering price, and the mutual fund receives the net asset value.

Underwriting and dealer agreements have always been part of the conventional process for distributing securities generally. One important ingredient of these contracts are provisions intended to provide assurance that the participants will protect the distribution and maintain the public offering price. The distribution of mutual fund shares under the Act was tailored to this format. Section 22 (d) of the Act, for reasons stated below, extended the obligation of maintaining the public offering price described in

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[20] In passing initially upon the rule, the Commission described its function, which applies as well to rule amendments, as follows:

> "The questions before us, therefore, are not only whether there is statutory authority [under Section 22 of the Investment Company Act] for the proposed amendment, but also, if such authority exists, whether the amendment is 'consistent with the requirements of subsection (b)' of Section 15A. If the proposed rule lacks statutory authorization, or if it cannot be reconciled with the provisions of subsection (b) (7) [now (8)] of Section 15A, it is our *duty* under Section 15A (j) to disapprove it". *National Association of Securities Dealers, Inc.* 9 S.E.C. 38, 40 (1941).

a fund's prospectus even to those who were not contractually bound and who had been engaging in a secondary market in outstanding shares and undercutting the public offering price. The Act created "a sheltered, price protected market for merchandisers of fund shares", as the Commission has observed.[21]

As discussed below, because of Section 22 (d), as well as independent economic reasons, the secondary market in mutual fund shares is now sharply diminished. This market, both before and after the passage of the Act, has involved a dealer acting as a principal. There has never been a brokerage market. The Commission, however, as discussed below, in November 1974 announced a proposal looking to the introduction of a brokerage market on a circumscribed basis and with special features necessitated by the peculiarities of mutual fund share distribution and the expressed Congressional policy of not impairing that system. Proceeding from the statutory theme of cooperative regulation, the Commission has enlisted the assistance of the NASD in this connection.

The above described features of mutual fund shares and of the statutory framework has led the Commission to characterize the shares as "a peculiar type of security", and to observe:

> "The nature of these shares and the manner in which they are distributed and redeemed are so extraordinary as perhaps to justify extraordinary treatment."

and then to point out:

> "It is reasonably apparent that, when the clause of Section 15A regarding a free and open market was adopted by the Congress, the legislators were addressing themselves to the market for more traditional types

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[21] 1966 Commission Report referred to at p. 32, *infra*, at p. 56.

of securities and did not have in mind the peculiarities of open-end investment company shares."[22]

SUMMARY OF ARGUMENT

One count of the complaint alleges that the NASD and its members have, in violation of the Sherman Act, combined to prevent the growth of a secondary market in mutual fund shares. In naming the NASD, appellant suffered from basic misconceptions, and as a result it has repudiated the keystone of its complaint, that the NASD established and maintained rules that inhibited the development of secondary dealer and brokerage markets. Appellant now recognizes that the NASD rules apply only to the primary distribution of mutual fund shares, that they do not prohibit secondary market transactions, and that while the rules require a sales agreement, they do not require it to contain provisions restricting the operations of a secondary market. Rather than acknowledge its misadventure, appellant endeavors to salvage its complaint by referring to a 15 year old letter the NASD sent to its members as to which appellant takes contradictory positions. The letter is irrelevant because it dealt with the primary distribution of mutual fund shares emanating from the issuer, and *not* the secondary market in outstanding shares that had been distributed to investors.

Appellant, enlarging upon a Commission interpretation, seeks to create a dichotomy between the Investment Company Act and the antitrust laws for one segment of mutual fund sales charges, i.e., in transactions between investors which involve a dealer acting only as a broker. Otherwise,

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[22] *National Association of Securities Dealers, Inc.* 9 S.E.C. 38, 45, 46 (1941). The Commission made the above comments in rejecting arguments by non-contract dealers that one of the redemption provisions of Section 26 of the NASD Rules of Fair Practice impeded a free and open market and created unfair discrimination.

appellant acknowledges that the sales charges to investors in *all* mutual fund share transactions, whether in the primary distribution or in the secondary market, are governed exclusively by the regulatory pattern of the Investment Company Act.

The Investment Company Act, by providing for retail price maintenance and accepting contractual restrictions, is designed to protect the primary distribution system, including its fixed sales charges, from the price competition of the secondary market. Section 22 (d), which was proposed by the mutual fund industry, extended the obligation of retail price maintenance to non-contract dealers, who had been able to undercut the public offering price in their trading in outstanding shares, thereby causing defections in the ranks of the competitively disadvantaged contract dealers. Appellant does not accept this statutory purpose, although the Commission has viewed it as such over the years, and the Congress reaffirmed this purpose when it reenacted Section 22 (d) in enacting the 1970 amendments to the Act, a subject which appellant wholly ignores.

The question of sales charges, the issue in this case, was a focal point of those amendments, which were preceded by a Commission report that had concluded that sales charges should be lowered. The Congress at great length reviewed the matter, including the absence of competition and of a secondary market for mutual fund shares. Section 22 (d) was referred to repeatedly as providing an exemption from the antitrust laws. The matter of sales charges was approached as not being within the ambit of those laws. The Congress rejected the Commission's proposal for a statutory ceiling on sales charges. Next, because of a concern, *inter alia,* with the adverse effects of a competitive secondary market on the primary distribution system and on the funds themselves, it rejected the repeal of Section 22 (d), which would have revived the secondary market and provided

competition in sales charges. The advocates of repeal included appellant. The Congress decided to leave the regulation of sales charges as it was, under the aegis of the NASD and Commission, but to prescribe new statutory standards in place of the then existing standard, which was found wanting.

The Commission was instructed to make a study of the consequences of price competition if Section 22 (d) were repealed. After a study and hearings, the Commission, on November 4, 1974, released a report of its staff that included a recommendation for the matching of buy and sell orders, on an agency basis, in a secondary market at competitively determined prices and commission rates. To implement the recommendation, the Commission has requested the NASD to amend its rules to prohibit agreements that restrict the matching of orders, recognizing at the same time that the NASD rules do not require such restrictions.

In recognition of the statutory policy, which appellant rejects, the Commission is not proposing a conventional brokerage market. It will impose certain conditions to help to neutralize any adverse impact of these proposed brokerage transactions on the primary distribution system. For example, funds will be permitted to introduce a novel transfer charge, part of which may be paid to the underwriter for promotional efforts, and there will be special trading restrictions. The Commission's action proceeds from the premise of the propriety, as well as its regulatory authority over, contractual restrictions in sales agreements, and reflects its judgment that the statutory policy does not permit the flat termination of contractual restrictions dictated by the different policy of the antitrust laws, as appellant urges, but compels regulatory intercession and oversight. The matter at hand, therefore, is not one for resolution under the antitrust laws.

ARGUMENT

I. THE MISCONCEIVED COMPLAINT AGAINST THE NASD

The NASD is named only in Count 1 of the complaint. That count alleges that the NASD and its members have, in violation of Section 1 of the Sherman Act, 15 U.S.C.1, combined to prevent the growth of a secondary market in mutual fund shares. The contractual restrictions as to the secondary market, which form the basis of the other counts in the complaint, are not required by the NASD, either by its rules or otherwise.

In naming the NASD, appellant labored under basic misconceptions. The complaint mounted a broadside attack on the NASD rules. This was the keystone. Thus, the complaint (¶17, J.A. 9) alleges that to effectuate the alleged combination and conspiracy the NASD

> "(a) established and maintained rules which inhibited the development of a secondary dealer market and a brokerage market in mutual fund shares;
> "(b) established and maintained rules which induced broker/dealers to enter into sales agreements with principal underwriters, with knowledge that sales agreements contained restrictive provisions which inhibited the development of a secondary dealer market and brokerage market in mutual fund shares;"

In its memorandum and reply in support of its motion to dismiss filed in the court below, the NASD, on the basis of the statutory plan described herein previously, pointed out: (1) that under the Maloney Act, the forum for an attack on NASD rules was not the court but rather the Commission, which had exclusive jurisdiction of the matter, (2) that like all its rules, the one NASD rule—Section 26 of the NASD Rules of Fair Practice—dealing with the distribution of mutual fund shares, had been specifically passed upon by the Commission under the Maloney Act, and also

the Investment Company Act, and (3) that the NASD rules enjoyed antitrust immunity. Furthermore, the NASD reviewed in detail the aforementioned Section 26, which made it clear that there was no warrant for appellant's allegations.

Confronted with these considerations, at the oral argument below, appellant made a hasty retreat and repudiated the foregoing allegations. It was announced, as it later confirmed by letter to the court, that the complaint was not attacking any NASD rules.[23]

Appellant still finds itself in this anamolous posture. It states (Br. 51, note 47) that it is not challenging the validity of the NASD rules, the heart of its complaint. Indeed it is compelled to acknowledge that the NASD rules "apply only to the primary distribution of mutual fund shares" (Br. 51, note 47), that they do "not prohibit secondary market transactions" (Br. 49), and that while Section "26 requires sales agreements, it does not require them to contain provisions restricting the operations of a secondary

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[23] Following oral argument, the court below invited the Commission to participate in the case. The Commission advised the court by letter that it would likely participate if appellant were attacking the NASD rules, "over which the Commission is granted exclusive original jurisdiction by Section 15A of the Securities Exchange Act of 1934" (J.A. 323) and that if this litigation does "in fact constitute attacks on matters which are within the Commission's supervisory jurisdiction over NASD rules then the teaching of *Ricci* [v. *Chicago Mercantile Exchange,* 409 U.S. 289, 302-303n.13] and the very structure of the Maloney Act require you to conclude that these cases cannot be maintained under the antitrust laws" (J.A. 325-326), pointing out in this connection that Section 15A(n) provides an "express antitrust exemption" (J.A. 326, note 5). Letter of August 9, 1973, from Lawrence E. Nerheim the Commission's general counsel (J.A. 323). In response, appellant advised the court by letter of August 20, 1973 that it was not attacking the NASD rules (J.A. 327).

market" (Br. 48).[24] As appellant has now learned, Section 26 of the NASD Rules of Fair Practice deals with the primary distribution of mutual fund shares from their issuers, through the intermediary underwriters and dealers, to the ultimate investors.[25]

Reflecting more of this misconception, the complaint alleges that to further the conspiracy the NASD

> "discouraged persons who made inquiry about the legality of a brokerage market from participating in a brokerage market and distributed misleading information to its members concerning the legality of a brokerage market in mutual fund shares;" (J.A. 9).

Appellant now disengages itself from this allegation. Having learned the facts from the NASD presentation below, it now points to and embraces (Br. 41; 61, note 54) the NASD manual to its members. This manual has stated for many years, on the basis of a Commission staff opinion which will be discussed later, that a brokerage transaction at less than the public offering price solely between investors is not prohibited by virtue of Section 22 (d) of the Investment Company Act. Appellant also cites letters from the NASD for the same proposition (Br. 41). It could

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[24] The relief requested also reflects appellant's intended attack on the NASD rules and is predicated on misconception. The prayer of the complaint is cast in terms of enjoining the NASD from "establishing, maintaining or adhering to any rule . . ." etc. (J.A. 19) This contradicts the rule making procedures and Commission jurisdiction as contemplated by the Maloney Act and the Investment Company Act discussed earlier.

[25] Again, now that it has learned the facts, appellant acknowledges (Br. 51, note 47) that the NASD rules do not fix prices. Its complaint, however, would enjoin the NASD from fixing the price for a brokerage transaction (J.A. 19).

find even more. See, e.g., *What You Must Know* (1964), p. 57, an NASD pamphlet dealing with mutual funds.[26]

Faced with a complaint rent by its own concessions, appellant seeks to salvage its case by reaching back 15 years to cull out, from the reams of material that had been submitted to it by the NASD long before the filing of the complaint, an isolated letter of June 22, 1959, from the NASD to its members. It is this letter alone that appellant has in mind when it speaks of "unofficial interpretations and extensions of rules to restrict secondary markets" (Br. 51, note 47, citing GX-6, 14-19, J.A. 251, 268-280), and which is the fuel for the repeated references in its brief to collusion, combination, collective action, etc.[27]

The June 22, 1959 letter (GX-18, J.A. 278), however, is irrelevant to this action because it dealt with the primary distribution of shares by the issuer, as will be shown below. Moreover, appellant's own position as to the letter is contradictory. It acknowledges in effect that the letter did not restrict the secondary market. Then, in utter disregard of this concession, it makes arguments about the letter, which however camouflaged, are a challenge to Section 26 of the NASD Rules of Fair Practice, notwithstanding appellant's assurance that the complaint does not "seek to overturn any NASD rule" (Br. 51).

The letter dealt with the primary distribution of shares emanating from the issuer, and *not* the secondary market in previously issued and outstanding shares. Even under appellant's specially tailored concepts (Br. 7, note 6), it must acknowledge that the subject of the letter was the primary distribution of shares from the issuer. Contrary to

[26] The complaint would require the NASD to include in its manual the references to brokerage transactions (J.A. 19) that appellant now acknowledges are already there.

[27] Appellant filed some 30 exhibits below. It has presented its case. The NASD submitted no evidence.

appellant's intimations (Br. 61), the letter had absolutely nothing to do with the secondary brokerage market. Nor did it deal with a purchase from an investor who might be the potential beneficiary of a price advantage in the secondary dealer market, the *raison d'etre* for that market's espousal by appellant (Br. 10). The letter dealt with non-contract dealers participating in a primary distribution of shares to investors. It did not affect the price paid by the investor. Under Section 22 (d) of the Investment Company Act, as appellant recognizes (Br. 9), such non-contract dealers must sell to an investor at the public offering price.

The letter dealt with the situation of contract dealers who took down shares from the underwriter to fill orders—at a discount from the public offering price—from non-contract dealers. As indicated in the letter, this practice permitted a non-contract dealer to evade the intent of Section 26 (c) of the NASD Rules of Fair Practice, which requires that a dealer in the primary distribution have a contract with the underwriter, and of Section 26 (f) (2), which permits a dealer to take down shares from the underwriter only to cover orders he has already received.[28] The letter

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[28] Section 26 (c) "requires a sales agreement, between the underwriter and any dealer interested in primary distribution . . .", as the NASD explained to the Commission when it considered the rule before its adoption. Public Conference on a Proposed Amendment to the Rules of Fair Practice of the National Association of Securities Dealers, Inc. (1941), p. 8 ("1941 Public Conference"). The Commission in passing upon the rule pointed out:

> "The primary distribution of the shares of open-end investment companies is customarily made through underwriters and dealers having sales agreements with the issuer or principal underwriter. Paragraph (c) . . . in effect requires such an agreement by providing that a member of the Association who is a principal underwriter may not sell to another member at a concession from the public offering price unless a sales agreement is in effect between the parties".

(Footnote continued on next page)

stated that the situation to which it was addressed may be corrected through amendment of sales agreements.[20].

Appellant takes contradictory positions with respect to the letter. It states: "While Rule 26 requires sales agreements, it does not require them to contain provisions restricting the operations of a secondary market" (Br. 48). The fair implication of this statement is that appellant finds no fault with the requirement of Section 26 (c) that a dealer participating in a primary distribution have a sales agreement with the underwriter. The June 22, 1959, letter simply sought to prevent the circumvention of this requirement, which appellant in the above quotation accepts as

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(Footnote continued from preceding page)

National Association of Securities Dealers, Inc., 9 S.E.C. 38, 44 (1941).

Section 26 (f) (2) prohibits a member (other than a dealer buying for his own investment) from purchasing shares from the issuer or underwriter "except for the purpose of covering purchase orders already received." The purpose of Section 26 (f) was "to eliminate any extra undisclosed profits by dealers and underwriters at the expense of the issuers and/or investors", as the NASD explained at the Commission hearing on the rule before it became effective. 1941 Public Conference, pp. 9-10. If Section 26 (f) were not construed as referring to orders received from the public, non-contract dealers who purchased through the contract dealer could "inventory" the shares and derive profits at the expense of the existing security holders, which Section 26 (f) was intended to deny.

[20] The amendment would have been to the effect that shares (other than for bona fide investment by the dealer) may be taken down at a discount only to fill orders in hand from members of the public. This is a common provision in agreements. The letter further pointed out that strict enforcement of selling group agreements will also serve to remedy the situation.

It is interesting to note that an NASD letter (GX-22) submitted by appellant states that if a non-contract dealer "is not willing to arrange for a selling agreement . . . the most practical course . . . is to obtain the shares in the open market . . ." (J.A. 290). Such advice hardly comports with the scenario appellant has composed and the role it assigns to the NASD as an instrument for inhibiting the secondary market.

not "restricting the operations of a secondary market." In these circumstances, the fact that the letter sought to achieve observance of this requirement, through an interpretation of Section 26 (f) (2), consistent with the purpose of that provision, should afford appellant no ground for complaint. This is particularly so since Section 26 (c) requires that the sales agreement contain the provisions of Section 26 (f), which appellant also recognizes as "not restricting the operations of a secondary market."

The foregoing acknowledgment by appellant, which correctly reflects the nature of Section 26, disposes of the June 22, 1959 letter. But then at a later point in appellant's argument the letter is transformed. By virtue of the letter, appellant asserts that Section 26 had the effect of inhibiting the development of secondary markets (Br. 51, note 47). In an effort to avoid the jurisdictional problem under the Maloney Act which this approach generates, appellant engages in razor edge semantics. It states that it is not challenging the NASD rules, but their "effect" (Br. 51, note 47). Appellant's hypothesis evidently is that an NASD rule —which enjoys antitrust immunity under Section 15A (n) of the Maloney Act—and its effects are severable, with the Commission's exclusive, embracing and continuing jurisdiction described earlier so sterile that it somehow encompasses consideration of the rule itself without regard to its impact, which is a distinct subject to be considered separately in some other forum under the antitrust laws. The matter need not be labored. The Commission is fully fortified with jurisdiction to consider the effects of an NASD rule or its interpretation, and to determine whether it implements or contravenes the statutory standards, including the Maloney Act "restrictions . . . upon anti-competitive rules"[30] and the purposes of the Investment Company Act. See notes 4 and 20, *supra*.

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[30] *National Association of Securities Dealers, Inc.*, Securities Exchange Act Release No. 9682 (June 7, 1972) p. 5.

Although for the reasons stated, including appellant's own acknowledgments, the June 22, 1959 letter is irrelevant, we shall nevertheless make some further observations about the letter in view of the attention given it by appellant as it endeavors to inject it into this proceeding.

Our Motion to Dismiss filed in this Court (pp. 14-19) contains a full description of the entire background of the letter. That narrative, which need not be repeated here, shows, contrary to appellant's intimations, that the letter was wholly consistent with the advice received from the Commission's staff and was communicated to the NASD membership in accordance with the wholly proper, general practice of the NASD to inform its members of advice it receives from the Commission or its staff.

Appellant originally thought, as it urged below in its brief in opposition to our motion to dismiss, that the letter had to be submitted to NASD members for a vote and had not been as part of some clandestine intrigue which even resulted in the letter's concealment from the Commission. Appellant no longer makes these assertions. It has now learned that no vote was required in view of *National Association of Securities Dealers, Inc.*, 17 S.E.C. 459, 465 (1944) and that NASD letters to its members are routinely sent to the Commission as part of its continuing oversight.[31] Nevertheless since this vintage letter has, as a result of lack of any remaining postulate of wrong, become the strand on which appellant seeks to hang its case against the NASD, appellant has now decided that an evidentiary hearing is necessary as to the circumstances surrounding this irrelevant letter (Br. 61-62).

The purpose of this judicial hearing under the antitrust laws would be to determine whether the letter "was in fact necessary to implement effectively the Investment Company Act, and was no more restrictive than necessary". The

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[31] See Rule 15Aj-1(d), 17 C.F.R. 240.15Aj-1(d) adopted by the Commission under the Maloney Act.

antitrust court would thus in effect review, in terms of the foregoing standards, the NASD rule and the action of the Commission.[32] In passing upon the rule the Commission has already concluded, as pointed out above, that it was authorized by Section 22 of the Investment Company Act and was consistent with the competitive criteria of the Maloney Act. Appellant's approach would nullify Section 15A (n) of the Maloney Act and the antitrust immunity it provides. See *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 357-360, see also note 23, *supra.*[33]

In its efforts to press this case into the antitrust mold appellant endeavors generally to minimize the role and involvement of the Commission in the activities of the NASD. For example, it portrays the Commission's function as if it were peripheral (Br. 54). However, the fact is that the Commission, by virtue of the Maloney Act and the Investment Company Act, exercises comprehensive oversight and review over the activities of the NASD. They are under

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[32] This contradicts appellant's statement that "it does not question any action taken by the Commission nor seek to overturn any NASD rule" (Br. 51).

[33] Appellant mentions (Br. 11), but never elaborates on the allegation in the complaint of suppression of market quotations. It is well advised, for it would suffer more of the frustration it has already experienced in attempting to mold an antitrust action on matters within the exclusive jurisdiction of the Commission. There is a network of statutory regulation to assure the integrity of quotations. Under Section 15A (b) (12), 15 U.S.C. 78o-3 (b) (12), the NASD is required, as it has, to adopt rules "designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations." See, e.g., NASD Rules of Fair Practice, Art. III, Sections 5 and 6. These rules are subject to the Commission clearance and oversight under the Maloney Act as discussed earlier. In addition, the Commission itself is specifically authorized to regulate the matter of quotations under Section 15 (c) (2) of the Securities Exchange Act, 15 U.S.C. 78o (c) (2). This is in addition to the general anti-fraud provisions of the Securities Exchange Act, which arm the Commission with direct regulatory authority, that would reach "suppressed" quotations.

the constant scrutiny of the Commission either through formal procedures or through the workings of the informal administrative process. Appellant also states (Br. 48) that in approving Section 26 of the NASD Rules of Fair Practice, the Commission's action was one of "non-disapproval". The Commission's role, however, is neither passive nor non-participatory. As already stated, the Commission is under a "duty" to reject or rescind an NASD rule as to mutual funds, if it, for example, is not authorized by Section 22. See note 20, *supra*. Yet appellant, without any warrant, states that the Commission's action "does not imply that the rule is necessary to the implementation of the regulatory scheme" (Br. 48, note 42).

We shall now turn to a consideration of the complaint's approach to the Investment Company Act, and where necessary as an incident to the analysis, reference will be made to contractual restrictions which are the subject of Counts II to VIII of the complaint, although such restrictions are not required by the NASD, either by rule or otherwise.

II. SECTION 22 OF THE INVESTMENT COMPANY ACT PROTECTS THE PRIMARY DISTRIBUTION SYSTEM. ITS DESIGN IS REGULATION RATHER THAN COMPETITION AND CARRIES WITH IT IMMUNITY FROM THE ANTITRUST LAWS.

The essence of appellant's complaint is that the effects of the present system of selling mutual funds shares, in the language of the court below, is to "cause the public to pay artificial and non-competitive sales loads for mutual fund shares," (J.A. 334). Appellant is endeavoring through the antitrust laws to achieve competitive sales charges in some mutual fund sales.[34]

Appellant acknowledges that the regulatory pattern of the Investment Company Act, and not the competition of the antitrust laws, governs sales and charges to investors in

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[34] As appellant points out (Br. 9): "Only the 'load' or sales commission can be affected by sales in secondary markets."

both the primary distribution and in the secondary dealer market in issued and outstanding shares, the traditional sources of mutual fund shares for investor purchases. Appellant argues, however, that this admittedly broad and intended antitrust immunity does not reach one facet, a secondary brokerage market solely between investors, which has never yet existed and which the Commission for the first time is now proposing to introduce, and on a circumscribed basis.[35] Appellant would bifurcate the unity and regulatory pattern of the Investment Company Act and seeks to create, solely for this brokerage segment of sales of mutual fund shares, a dichotomy between the Investment Company Act and the antitrust laws. Appellant believes it has found a crevice in the statute's wall of antitrust immunity.

A. The Statutory Provisions

Section 22 of the Act deals specifically with each of the two components that make up the price of a mutual fund share, i.e., net asset value and sales load, and also with the price at which mutual fund shares are to be sold to investors both in the primary distribution and thereafter.

Section 22 (a) has remained unchanged since the Act was passed in 1940. In substance, it authorizes the NASD to adopt rules to protect existing shareholders from a dilution of their equity or other unfairness so that the "minimum price" at which shares may be purchased from a mutual fund (and also the "maximum price" which it may pay on redemption) is in "relation to the current net asset value" of the security.

Section 22 (b) by its terms deals with the sales charges in a primary distribution, but its impact carries over to the

[35] As will be discussed below, the Commission in its November 1974 report is not proposing a conventional brokerage market because of the very policy strictures of the statute which appellant's approach denies.

secondary market in issued and outstanding shares, as discussed below. Prior to 1970, when the statute was amended, Section 22 (b) in substance authorized the NASD to adopt rules so that the offering price would "not include an unconscionably or grossly excessive sales load." The 1970 amendments, which are fully explored below, continued the NASD rule making authority, but the standard was changed so that the offering price "shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors."[36]

NASD rules become effective only after they have been passed upon by the Commission in terms of their being authorized by Section 22 and consistent with the applicable standards of the Maloney Act. In addition, the Commission may adopt rules altering, supplementing or superseding NASD rules.[37] Thus, in effect, the Commission has exclusive jurisdiction of the matter.[38]

The 1970 amendments also added Section 22 (b) (4) to the statute which, in terms identical with Section 15A (n) of the Maloney Act, provides for antitrust immunity. Both the Senate and House Reports said of this section:

> "This provision, which is identical to Section 15A (n) of the Securities Exchange Act, is designed to make it clear that no other provision of Federal law, including the antitrust laws, prevents a registered securities association from adopting rules consistent with, and neces-

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[36] The amended Section 22 (b) relieves such rules from compliance with Section 15 (A) (b) (8) of the Maloney Act to permit rules prescribing methods for computing, and limitations on, sales loads.

[37] Section 22 (b) (3) and 22 (c) of the Investment Company Act.

[38] Section 25 (a) of the Securities Exchange Act of 1934, 15 U.S.C. 78y (a), and Section 43 (a) of the Investment Company Act, 15 U.S.C. 80a-42 (a), both provide for review of Commission orders by the Circuit Courts of Appeals.

sary to effectuate, the purposes and provisions of this section." Senate and House Reports, note 54, *infra*, at pp. 18 and 30, respectively.

Section 22 (d) of the Act provides for retail price maintenance. As discussed below, proposals for its repeal were rejected in connection with the 1970 amendments, and it was reenacted with amendments not here pertinent. Its reenactment was integral to the action taken by the Congress. Section 22 (d) provides in pertinent part:

> "No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus."

Section 22 (d) is of general application. It draws no distinction between newly issued shares in a primary distribution and transactions in the secondary market in already outstanding shares. Nor are its proscriptions limited to those who have sales agreements with the underwriter. As long as a mutual fund is offering shares—and this is the common situation—Section 22 (d) applies. Retail price maintenance is required; it is not permissive as appellant at one point states (Br. 53). It should also be noted that while Section 22 (b), which as pointed out above deals with the sales load, is cast in terms of the primary distribution, it is the load permitted under Section 22 (b), together with the per share net asset value, which determine the public offering price that must be maintained under Section 22 (d), even in the secondary market. Section 22 (d) refers to a "dealer", with no reference to a "broker". As

will be discussed below, this is attributable to the fact the secondary market has always been a dealer market; a brokerage market has never existed.

The secondary dealer market provides no monetary advantage to the purchasing investor. As appellant acknowledges (Br. 9) the retail price maintenance provisions of Section 22 (d) apply to *all* dealer sales to investors, including those made by noncontract dealers in the secondary market.[39] It applies as well, as appellant recognizes (Br. 25, 35-36), even if there is an intermediate broker, whether the broker acts for the customer, for the dealer, or for both.

B. The Purpose and Origin of Section 22

The objectives of Section 22 (d) have been explained by the Commission time and again in the following terms, with which appellant disagrees:

> ". . . the purposes of Section 22 (d) as stated by the Commission 'are to prevent discrimination among purchasers and *to provide for orderly distribution* of such shares by preventing their sale at a public price less than that fixed in the prospectus.' [citing Investment Company Act Release No. 2798 (December 2, 1958)] . . . Section 22 (d) seeks *to prevent* the adverse effect upon investors generally which would result from discriminatory pricing and *disorderly distribution.*"[40]

Prior to the passage of the Act, the so-called "bootleg market" provided secondary market price competition in mutual fund shares. This competition existed between

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[39] Accordingly, there is no basis for appellant's intimation that Section 22 only concerns itself with the "links in the primary distribution of shares from fund to underwriter to dealer to investor", or the analogy which it seeks to draw to state fair trade laws and the second-hand market (Br. 23-24).

[40] *Spiro Sideris,* Securities Exchange Act Release No. 8816 (February 13, 1970), p. 2.

contract dealers, who had distribution agreements with the principal underwriters and were obligated to sell fund shares at sales loads fixed by the principal underwriter, and dealers who did not have such an agreement and obtained shares from sources other than the principal underwriter, reselling them at whatever price they chose. This caused dealers to cancel their contracts with principal underwriters. As described in the Commission's Investment Trust Study that led to the passage of the statute initially, these non-contract

> "dealers would often offer a little more than the published redemption price and ask a little less than the published sales price . . . A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended to disrupt the established offering price." (Footnotes omitted.) [41]

A response to this competitive situation and its consequent disruption of the primary distribution was Section 22 (d), which came about in the following circumstances: The original bill recommended by the Commission did not contain this provision. Extensive Senate hearings were held on that bill,[41a] and the industry, while not opposing legislation, did not agree with the Commission's proposals. A spokesman for the industry suggested the framework of an acceptable bill.[42] With respect to Section 22, he stated that it

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[41] *Investment Trusts and Investment Companies,* Report of Securities and Exchange Commission ("the Commission Investment Trust Study"), Part 3, p. 865; see also Part 2, p. 241, n. 100.

[41a] Hearings before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, 76th Cong., 3d Sess. on S.3580 (1940).

[42] *Ibid.,* p. 1053.

"... should also provide that no securities issued by an investment company shall be sold *to insiders or to anyone* other than an underwriter or dealer except on the same terms as are offered to other investors."[43]

This proposal, almost in verbatim language, was again set forth in a memorandum agreement between the Commission and the industry.[44] This agreement produced a compromise bill[45] that included Section 22 (d) and was enacted. The Senate Committee Report on that bill states:

"In addition, provision is made to prohibit the sale of redeemable securities *to any person* other than a dealer or principal underwriter at a price less than that at which the security is sold to the public." Sen Rep. No. 1775, 76th Cong., 3d Sess., p. 16.

This statement, as appellant points out (Br. 32), makes no reference as such to the secondary market. However, it does not refer specifically to the primary distribution either. It embraces both by the general statement that sales of redeemable securities "to any person other than a dealer or principal underwriter" must be made at the public offering price. No distinction is drawn between the primary distribution and the secondary market. Sales to public investors in either are to be made at the public offering price; and Section 22 (d) so provides.

Appellant, nevertheless, argues (Br. 19-20), as its fundamental premise, "that Section 22 (d) was addressed to abuses in the primary distribution of mutual fund shares, not to secondary level transactions." However, appellant

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[43] *Ibid.*, p. 1057.

[44] Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce, H. Rep., 76 Cong., 3d Sess., on H. R. 10065, p. 99.

[45] *Ibid.*, p. 96.

acknowledges, as already stated, that Section 22 (d) —the purpose and intent of which reflects the above quoted statements—embraces transactions solely in the secondary market that are in and of themselves wholly unrelated to the primary distribution. This was not an inadvertence, as would seem to be the implication of appellant's approach. If Section 22 (d) were meant to deal only with abuses in the primary distribution, as appellant urges, it could and would have been so limited. The statute was drafted as it was because it was designed to frustrate the secondary market in its disruptive effect on the primary distribution system by denying the secondary market its competitive price advantage.[46]

In order to protect the primary distribution, the statute also accepted the denial to a selling shareholder of the opportunity of possibly receiving in the secondary market something more than the redemption price. This, as appellant recognizes (Br. 9-10), is the only possible price benefit that an investor could derive from a secondary dealer market.

The Commission's Investment Trust Study (Part 3, p. 865) pointed out that certain mutual funds attempted to overcome the price competition of the "bootleg market" by restricting the negotiability of their shares, and providing that they could only be sold or tendered for redemption to the mutual fund. These restrictions denied the selling shareholder the possible price benefit of the secondary market. Significantly, in disregard of this possible benefit, Section 22 (f) of the Act permits restrictions on transferability and alienability, subject to disclosures in the fund's

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[46] This is not to say that the statute does not also "protect open-end mutual fund investors against the dilution of their equity due to 'in-and-out' trading by insiders", the sole purpose ascribed to Section 22 (d) by appellant (Br. 32-33).

registration statement and Commission rule making authority, which it has thus far not exercised.[47]

In summary, the drafters of the statute, who arrived at the compromise that led to its enactment, were fully aware of the fact that there existed a competitive secondary market in mutual fund shares which might provide a price benefit to both the purchasing and the selling investor. They also knew that this secondary market produced adverse consequences on the primary distribution system from which the mutual fund industry wanted protection. And it succeeded. The conclusion was reached to deny price benefits in order to protect the primary distribution system.

C. The 1970 Amendments

Appellant simply ignores the wholly relevant subject of the 1970 amendments and their background as it must if it is to adhere to its approach. This material does not reveal any novelty of statutory purpose.[48] It confirms in detail the proposition, which appellant refuses to accept, that Section 22 of the Investment Company Act, with its retail price maintenance and its acceptance of contractual restrictions, is designed to protect the primary distribution system and its fixed sales charges from the competition of a secondary market. Although urged, the Congress deliberately refused to abandon this purpose; it reenacted Section

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[47] Congress was aware that there were contractual restrictions that "presents a whole problem which they call the bootleg market." Senate Hearings, note 41a, *supra*, p. 292. We shall not discuss the relationship of Section 22(f) to the contractual restrictions here involved, which we understand will receive detailed treatment in other briefs.

[48] Even if it did, it would be wholly relevant. In preoccupying itself exclusively with the 1940 legislative history and ignoring the 1970 amendments, appellant for all intents and purposes is engaging in an academic exercise of historical interest.

22 (d) and expressed unequivocally its intent to continue this design.[49] The whole matter of sales charges, to which appellant's complaint is directed, was approached as not even being within the ambit of the antitrust laws, a view then shared by appellant and communicated to the Congress. It was with the filing of the complaint here in Febuary 1973 that appellant for the first time asserted that the antitrust laws applied to sales charges.

The Congress fully considered the entire subject of the distribution and sale of mutual fund shares, including the secondary market and competition. Sales charges, the subject of this litigation, were a focal point of the Congressional deliberations. While the Congress wanted to protect the purchasing investor from excessive sales charges, it also wanted to assure the seller "reasonable compensation" not dictated by competition. It even refused to impose a statutory ceiling on sales charges. Congress was made fully aware of the situation to which appellant's complaint is addressed, that "sales of mutual fund shares have been confined to a primary distribution system" and that "the public has been deprived of the benefits of free and open competition" of secondary markets (J.A. 10). The Congress rejected competition and refused to revive the secondary market. The matter of sales charges was again committed to the Commission's jurisdiction, as it had been, but under new standards. It was viewed as a matter best treated in the administrative forum.

In 1966 the Commission submitted a report to the Congress in which it recommended statutory amendments in light of the developments that had taken place since the passage of the Investment Company Act in 1940. *Report*

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[49] These circumstances render inapposite appellant's quotation (Br. 40-41) from *Securities and Exchange Commission* v. *Capital Gains Research Bur. Inc.*, 375 U.S. 180, 199-200, and distinguishes *United States* v. *Philadelphia Natl. Bank,* 374 U.S. 321, which appellant also cites.

of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth (1966) ("the 1966 Commission Report").[50] The Commission's recommendations were embodied in bills introduced in the 90th Congress, and the matter was carefully considered by the Congress over a four year span. In 1967, hearings were held before the committees of both the Senate and the House of Representatives.[51] The Senate Committee reported out a bill,[52] which was passed by the Senate. The House Committee took no further action.

In the 91st Congress, bills were again introduced, and further committee hearings were held on both sides of the Congress.[53] This time bills were reported out by both committees,[54] and following a conference,[55] the amendments were enacted in 1970, Public Law 91-547. It may be noted that both the House and Senate bills (as was true

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[50] Printed as H. Rep. No. 2639, 89th Cong., 2d Sess.

[51] Hearings before the Committee on Banking and Currency, U.S. Senate, 90th Cong., 1st Sess., on S.1659; Hearings before the Subcommittee on Commerce and Finance of the Committee of Interstate and Foreign Commerce, House of Representatives, 90th Cong., 1st Sess., on H.R. 9510, H.R. 9511. Referred to as "1967 Senate Hearings" and "1967 House Hearings", respectively.

[52] S. Rep. No. 1351, 90th Cong., 2d Sess.

[53] Hearings before the Committee on Banking and Currency, U.S. Senate, 91st Cong., 1st Sess., on S.34 (which contained the text of the bill passed by the Senate in the 90th Cong.) and S.296 (1969); Hearings before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, 91st Cong., 1st Sess., on H.R. 11995, S.2224 (which was the bill passed by the Senate in the 91st Cong.), H.R. 13754 and H.R. 14737. Referred to as "1969 Senate Hearings" and "1969 House Hearings", respectively.

[54] S. Rep. No. 91-184; H. Rep. No. 91-1382. Referred to as "the Senate Report" and "the House Report", respectively.

[55] H. Rep. No. 91-1631.

also of the Senate Bill passed in the prior Congress) adopted the regulatory format embodied in Section 22 (b).

The 1966 Commission Report to the Congress called attention (p. 42) to the fact that there was only a small trading market for mutual fund shares. The report reviewed at great length (pp. 201ff.) the entire subject of the distribution of mutual fund shares, and particularly the sales load. While the Commission was of the view that existing sales loads should be lowered (pp. 221, 222), it indicated (p. 218) an inability to act under the then existing statutory standard proscribing "unconscionable or grossly excessive" sales loads.

Then the report (pp. 218 ff.) dealt at great length with retail price maintenance. Section 22 (d) was described as "an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing" (p. 218). Section 22 (d) was referred to as one of the "statutory controls with respect to sales loads" (p. 218). It was pointed out that Section 22 (d) "effectively prevents any price competition among dealers", and requires them to "adhere rigidly to the offering price whether the shares they sell are newly issued or already outstanding" (p. 218). It should be noted in this connection that the report used the term "dealer" in a generic sense to refer to a retail securities firm in the over-the-counter market without regard to the capacity in which it acts. Where the matter of capacity was relevant, it was delineated, e.g., p. 53. The references to "dealer" during the Congressional hearings and in the Congressional reports were also made in the same manner.

The background of Section 22 (d) was explained (p. 219) in terms of the "bootleg market" and its consequences basically as set forth herein earlier. It was then emphasized that Section 22 (d) is unique and is "an exception to the general rule that in the over-the-counter markets charges for executing transactions are subject to negotiation" (p. 219).

The report then addressed itself to possible methods of achieving the lower sales loads that the Commission sought. The report considered the elimination of Section 22 (d), pointing out that the advantage of such a step would be that it "would allow the proper level of sales loads to be determined by the freely active forces of retail price competition" (p. 222). The Commission rejected this approach because it could result in price discrimination. It "would permit knowledgeable investors to purchase mutual funds shares at sales loads substantially lower than those now prevailing, but others—among them those most in need of protection—might save little or nothing" (p. 222).[56]

The Commission then advocated a statutory ceiling and recommended in essence that "[s]ales charges for mutual fund shares may not exceed 5 percent of their net asset value at the time of sale" (p. 223). In this connection the Commission observed (p. 223):

> "Moreover, the mutual fund industry has operated for over a quarter of a century under the anticompetitive protection against price competition afforded by section 22 (d). A maximum sales load would avoid any unsettling and unforeseeable effects which abolition of retail price maintenance might have on the broker-dealer community . . ."

These "unsettling and unforeseeable effects", and the intimate interrelationship between the primary distribution and the secondary market in terms of the function and impact of Section 22 (d), were later elaborated upon during the Congressional hearings by the then chairman of the Commission:

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[56] The Commission also thought elimination of Section 22 (d) might at least temporarily favor captive organizations, which are not involved here, that are the sole distributors of the fund shares they sell (p. 222).

"They [the mutual fund industry] felt that the lifting of section 22 (d) would be disastrous for the funds and those who sell them. They said that the dealers who wanted to sell mutual funds would stop buying them from principal underwriters and purchase them at cut prices in the market, and that mutual fund sales charges would thereby be driven down to a point where most dealers would stop selling them at all. In other words, they said the force of competition would reduce the charge.

"They said that as a consequence the existing system of distribution would break down, the underwriters would be unable to make enough sales to offset redemptions, and the funds would be thrown into a net redemption status, and ultimately wither away." 1967 House Hearings, p. 713.

As will be seen, it was Congressional concern with these adverse consequences of a competitive secondary market on the primary distribution and on the funds themselves which, *inter alia*, led Congress to embrace regulation and reject competition.[57]

Although it would have been very much relevant, nowhere in its comprehensive report did the Commission even mention the administrative interpretation, on which appellant pivots its case and which will be discussed below, that Section 22 (d) does not prohibit a broker from effecting a transaction between customers at a price lower than the public offering price. Nor did the Commission, or anyone else, refer to it in the extensive Congressional hearings or voluminous memoranda that were submitted. In the single allusion by the Commission to the matter, its then chairman negated the interpretation:

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[57] Appellant nevertheless argues that "a secondary market cannot . . . undermine, or even adversely affect, primary distribution of fund shares at a 'current price offering price' ", and that "it was not a matter of concern to Congress." (Br. 20).

"The statute is unequivocal. No person, no matter where he gets it, from the issuer, from another dealer, or even from a private person, *no broker-dealer* may sell a share of a particular fund at a price less than that fixed by the issuer." 1967 House Hearings, p. 711.

There is not even an intimation in the 3500 page legislative record, to which we now turn, that there could be a deviation in any way from the sales charge fixed by the underwriter, or that the antitrust laws, which were referred to repeatedly, might in any way be relevant. On the contrary, the constant refrain, repeated time and again, was the immutability of the fixed sales charge and that the whole system of pricing and sales charges was free of the antitrust laws. These were the postulates. The absence of competition was the recurring theme. This is not a case where the legislative record is silent or ambiguous on the application of the antitrust laws so the matter must be resolved by implication. The record here is explicit. The Congress intended that Commission regulation should supplant competition, the object of the antitrust laws, in the whole area of pricing and sales charges.

At the outset of the 1967 Senate Hearings the committee chairman observed (p. 1) that the Commission's report "correctly emphasized the serious problems" that had arisen since 1940, "especially in the area of mutual fund sales commissions . . ." The chairman of the Commission referred to sales charges as a "major" problem that has "received the greatest attention" (pp. 5, 25, see also p. 126). His presentation essentially repeated the observations and recommendations in the 1966 Commission Report previously summarized. He referred to the Act's "special exemption from the antitrust laws" (p. 87) and to "the unique structure of this industry and existing restraints on competition, some imbedded in the act itself—and I have particular reference to section 22 (d) " (p. 4). He also observed, for example,

"mutual fund sales charges are not determined by the normal interplay of freemarket forces." (p. 25)

* * *

"It [Section 22 (d)] permits the fund's principal underwriters to fix sales charges and then requires the Federal Government to enforce adherence to those prices by every retail dealer whether or not he has a contract with the underwriter and whether or not he is engaged in the initial distribution of the fund's shares." (p. 25)

* * *

"If a retail dealer sells shares of a mutual fund for less than the price which is . . . stated in the prospectus because the dealer believes lower charges will enable him to increase his sales and his profits, he is guilty of a wilful violation of the Investment Company Act." (p. 25)

* * *

"Sellers of mutual fund securities have been insulated by Federal law from price competition at the retail level since 1940." (p. 26)

See also 1967 Senate Hearings, pp. 32, 50-51, 82, and 86.

This testimony was elaborated upon in a written statement (pp. 142-155), with reference again to the "exemption from the antitrust laws" (p. 142) and also to the pre-1940 "bootleg market" and Section 22 (d) (pp. 151, 153). In this connection it was pointed out that "we are dealing with an industry that had never known retail price competition"; that even before 1940 "there was a considerable degree of insulation from price competition by private contract"; and that the "competition that existed in the pre-1940 period seems to have had a truly disruptive effect . . ." (p. 153). The reasons were again recited for the Commission's not advocating competition, but a prescribed maximum sales load (p. 154), which was also the subject of another memorandum (pp. 173-174).

The chairman of the Senate Committee in describing the Commission proposal stated (p. 185):

> "In the area of sales loads, the Commission has suggested that in view of the statutory and other restraints on the normal forces of free price competition, a statutory ceiling on sales charges is required."

The Commission made a similar presentation at the 1967 House Hearings, e.g., pp. 30, 48-61, 109-114, 140-143, 193-197, 692, 701-703, 707, 713-715. In written memoranda it pointed out, for example:

> ". . . sales charges . . . are fixed under an exemption from the antitrust laws which prohibits price competition by dealers . . ." (p. 48).
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> * * *
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> "They [sales charges] are . . . fixed and maintained . . . under an exemption from the antitrust laws . . . . No dealer *anywhere* (not even a dealer who has no contract or contact with the principal underwriter and who obtains shares from other sources, *including investors*) can deviate from the price that the principal underwriter has set." (p. 701; a similar statement was made in the 1967 Senate Hearings, p. 142).
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> * * *
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> "Mutual fund sales charges are not free market prices determined by competition. They are fixed under an exemption from the antitrust laws . . ." (p. 109).
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> * * *
>
> ". . . to introduce a competitive regime in this industry would be to break too sharply with its established ways of doing business" (p. 113).

The then Commission chairman in his testimony twice referred to Section 22 (d) as an "exemption from the antitrust laws" (pp. 140, 707) and observed (p. 673):

"It is a system under which the Federal Government authorizes the industry to operate outside the controls of the antitrust laws, . . ."

The Commission proposal met with a storm of opposition. The committee record in both houses is replete with testimony of witness after witness and written submissions, which condemned the proposal. In the process there was a thoroughgoing review of the distribution and sale of mutual fund shares, the level of sales charges, the need to assure sellers of mutual funds adequate compensation if they were not to be forced out of business, and the drastic consequences that would follow if the Commission's proposed statutory ceiling were enacted.[58] The Commission proposal did not prevail and, as will be shown, the Congress gave heed to these considerations in setting standards for sales charges.

Next, there were those, including appellant, that advocated the repeal of Section 22 (d), and the proposal was even embodied in a bill. This would have permitted the competitive sales charges of a secondary market. Repeal would not have terminated the contract primary distribution system, but would have revived the secondary market as its price competitor, and the resulting investor benefits were urged upon the Congress. Repeal would have restored the "disorderly distribution" which the statute terminated in 1940, and it was rejected by the Congress.[59]

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[58] See 1967 Senate Hearings e.g., pp. 187-188, 215, 225, 248, 267, 278, 302, 329, 551, 605, 646, 655, 658, 736, 751, 770, 779, 782, 788, 791, 809, 818, 873, 960, 964, 985, 986, 997, 998, 1077, 1097, 1100, 1112, 1117, 1129, 1166; 1967 House Hearings, e.g., pp. 233-237, 252, 265, 266-268, 282, 285, 293-297, 317-322, 325-334, 349-350, 381-383, 400-401, 405, 408, 467, 474-476, 484, 492-493, 496-497, 526, 528, 561, 563, 622, 625, 779, 782-783, 789, 820, 834, 835, 839, 840.

[59] As will be shown, the prevention of "disorderly distribution" was of primary concern also to the Commission in its November 1974 report.

In 1967 appellant recognized that "the fixed price policy embodied in Section 22(d)" provides "the mutual fund industry an exception to the basic competitive requirements of the antitrust laws." It urged, however, that the small investor "should not perhaps be deprived of the opportunity of purchasing his investment at a price arrived at through the free operation of competitive forces." 1967 House Hearings, p. 21.[60]

Appellant's position during the 1969 House Hearings (pp. 135-136) is of particular moment and stands in sharp contrast with its current utilization of the antitrust laws to treat with the matter of sales charges. At that time, the Senate had passed its bill, but the House Committee had not yet reported a bill. Appellant called attention to the fact that the Senate Committee report "takes account . . . of the fact that Section 22(d) . . . prescribes a unique scheme of retail price maintenance for . . . sales charges . . .", and points out that such charges for much higher than those otherwise prevailing in the securities industry. However, appellant continued, because the committee lacked adequate information as to the consequences of the repeal of Section 22(d), it had requested a report on the subject from the Commission, and had proposed an amendment (which was enacted) to permit associations of securities dealers to deal with the problem of excessive sales loads. Appellant then stated:

> "*These steps are not inappropriate as interim measures.* However, the Department believes that con-

[60] Appellant at the same time stated:

> "It is our understanding that some consideration has heretofore been given to the possibilities of eliminating the price maintenance features of section 22(d) from the statute. Because of the nature of the security business, however, *it has apparently been the view that to leave the matter to the free play of competitive forces would make for disorder in the industry.*" 1967 House Hearings, p. 21.

tinued attention should be given to the abolition or amendment of Section 22 (d). The arguments for retaining Section 22 (d) have not appeared persuasive to us, and we continue to think it likely that close examination of them will reveal that price competition in sales commissions can be allowed with advantage to investors."

A fair reading of the foregoing would indicate that appellant was accepting the Congressional formula and procedure for dealing with the sales load problem. Indeed, appellant even participated in the hearings that the Commission conducted to implement the Senate Committee's request for a report. Certainly, there was no intimation that appellant, which had earlier advised the House Committee that the mutual fund industry enjoyed an exemption from the antitrust laws, thought that the antitrust laws could be invoked to achieve the "price competition in sales commissions" which it favored and which the Congress refused to accept without further study of the matter, leaving the sales load problem for administrative regulation by the Commission. As will be shown, the House Committee paid special attention to appellant's espousal of competition.

The advocates of repeal also included Professor Paul A. Samuelson. He urged repeal of Section 22 (d) so that "there would spring up a secondary market for . . . mutual funds." 1967 Senate Hearings, pp. 348, 356, 366; see also, 1969 Senate Hearings pp. 55, 58, 64. In the latter hearings he stated (p. 62):

> "Government now makes it impossible for there to be a free secondary market in mutual funds."

Professor Richard W. Jennings, who shared Professor Samuelson's views, observed that "there is no competition at the retail sales level" and that "there is a noncompetitive situation by Government action", pointing out:

> ". . . if I want to sell my mutual fund shares, I have to sell those back to the company, or if I want to buy,

> I can't buy them on the open market. If you repeal 22 (d) there would develop a market by buyers and sellers which would cut that cost." 1967 House Hearings, pp. 639, 647, 649.

In this connection a financial editor observed: "There are no discount houses in mutual funds." 1967 House Hearings, p. 655.

The views expressed to both the Senate and House Committees in 1967 by Professor Henry C. Wallich are of particular moment for they bring into focus the potential benefits of a competitive secondary market to both buyers and sellers. Referring to the consequences of the repeal of Section 22 (d), which he then favored, he observed:

> "It is claimed that a 'bootleg', i.e., free market would then arise in which investors wishing to redeem could sell their shares at slightly more than the current market value which the fund itself offers. The shares would then be resold for less than what the fund would charge (including sales load). Such a market which would be perfectly legitimate, would obviously be beneficial both to investors who redeem and who purchase. The fund would lose the sales load on the shares turning over in the market instead of being reissued by it . . . the availability of shares in the market would drive down the sales load . . ." 1967 House Hearings, p. 586; to the same effect, 1967 Senate Hearings, p. 1064.

During the 1969 Senate Hearings (pp. 144-147, 152) Professor Wallich, however, stated that he would hesitate to recommend the repeal of Section 22 (d) without examining the damage it might do to the mutual fund industry.[61]

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[61] Professor Sidney Robbins also recommended extensive studies before eliminating or modifying Section 22 (d). 1967 Senate Hearings, p. 255.

The chairman of the Council of Economic Advisers suggested: "The possibility of eliminating present restrictions against full competitive freedom in setting sales commissions deserves thorough consideration as an alternative or a supplement to the proposed ceiling on load charges," 1967 Senate Hearings, p. 957.

Repeal of Section 22 (d) was also proposed by others. See 1967 Senate Hearings, pp. 667-670, 731, 1018; 1969 Senate Hearings, pp. 173, 183; 1969 House Hearings, p. 775.

A proposal to repeal Section 22 (d) was embodied in a bill introduced in 1969 by Senator McIntyre, one of the members of the Senate Committee. S.296, 91st Cong., 1st Sess., §12 (a). Senator McIntyre stated that Section 22 (d) "makes it a Federal crime for salesmen to offer shares with commissions different from those established by the fund's underwriter" and that his bill "would permit commission levels to be established by the free interplay of competitive forces in the open market." 1969 Senate Hearings, p. 5.[62]

In response to questioning by Sen. McIntyre, a Commission spokesman stated:

> ". . . we don't know what conditions will result in the marketplace if 22 (d) is repealed.
>
> "We are told that wildcatting and price cutting will be ruinous to the industry. It might well be. We don't know the answers to those questions and to those possible results. It is because of that area of darkness that

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[62] A committee staff report summarized this provision in Senator McIntyre's bill as follows: "Repeals sec. 22 (d) of the Investment Company Act. Sec. 22 (d) allows mutual fund distributors and underwriters to fix sales commissions at a set price and makes it a Federal crime for *any broker-dealer* to sell these shares at a lower price. Repeal of Section 22 (d) would allow the competitive forces of the market place to determine mutual sales commissions." 1969 Senate Hearings, p. 4.

> we just didn't feel we had enough economic background and strength to come up here and recommend a repeal of this section." 1969 Senate Hearings, pp. 18-19.[63]

The Commission took the same position on the repeal of Section 22 (d) during the 1969 House hearings. The then chairman of the Commission twice again referred to Section 22 (d), "as an exemption from the antitrust laws" (p. 259, 862), "which prohibits retail dealers from engaging in retail price competition for customer favor" (p. 864). His attention was directed by the chairman of the House subcommittee to "a rather carefully considered opinion of the Department of Justice, that this section [22 (d)] be repealed" (p. 901), and the Commission chairman observed:

> ". . . it was represented to us that it would have very serious effects upon the industry. We had no means of measuring whether or not that was true, and just in an abundance of caution we refrained from making that recommendation."[64]

Instead of sales charges being determined by competition, or imposing a statutory ceiling on those charges, the Congress concluded that the matter should be left for reso-

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[63] For the industry's description of the adverse consequences that would result from the repeal of Section 22 (d) see e.g., 1967 Senate Hearings, pp. 320-322, 600-604, 608; 1969 Senate Hearings, pp. 91, 101-104, 119, 206, 425; and 1967 House Hearings, pp. 285, 827, and 830-832.

[64] Earlier in his testimony he had pointed out that the Commission's consideration

> "began with the suggestion that section 22 (d), the legal barrier to retail price competition, be repealed and normal market forces set price levels of mutual funds. It was suggested that, if this happened, fund distribution systems would be destroyed, dealers would no longer sell fund shares, funds would fall into a net redemption status and dump their portfolio securities . . ." 1969 House Hearings, pp. 864; see also p. 183.

lution under the jurisdiction of the Commission. As the Senate Committee pointed out, it was

> ". . . decided to rely on the existing self-regulatory machinery of the securities industry in order to protect public investors against unreasonable sales charges subject to appropriate Securities and Exchange Commission oversight." Senate Report, p. 8.

This was reiterated in the House Report (pp. 4-5).

As has been indicated, the statutory standard in Section 22 (b) relating to sales loads, which are applicable in both the primary distribution and secondary market, was refashioned. The standard to guide the NASD and the Commission in formulating rules as to sales loads reflected, *inter alia,* the extensive testimony that had been presented with respect to need for adequate sales charges. Section 22 (b) seeks to "assure that fair consideration is given to the interests of both sellers and investors." Senate Report, p. 18; to the same effect, House Report, p. 4. This statutory concern with "reasonable compensation for sales personnel, brokers-dealers, and underwriters" is the antithesis of sales charges determined by competition under the antitrust laws.

Because the rule making authority of the NASD was expanded, an exemption from the antitrust laws was specifically added in Section 22 (b) (4), even though appellant thought it was not necessary.[65]

The Senate Report (pp. 7-8), and also the House Report (p. 3) in practically verbatim language, stated:

> "The basic sales commission charged for mutual fund shares . . . is protected by Section 22 (d) of the Investment Company Act which provides for a unique scheme of retail price maintenance. Under this sec-

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[65] 1967 House Hearings 345.

tion, *all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime.*"

The Senate Report in this connection pointed out (p. 8) that shares of "particular mutual funds are not sold on a 'bid and asked basis' as are other securities offered and sold in the competitive over-the-counter market."

The two committee reports further pointed out that under the amendment ". . . *sales loads* fixed by principal underwriters . . . *continue to be protected against price competition* by section 22 (d) of the Act . . ." Senate Report, p. 18; House Report, p. 30.

Yet appellant urges that Section 22 (d) ". . . favors transactions in the secondary market at competitively fixed prices different from the . . . offering price . . ." (Br. 40).

In this connection the Senate Report (p. 8) pointed out that mutual fund sales charges are much higher than those that prevail elsewhere in the securities industry. It pointed out that the basic New York Stock Exchange commission is about 1 percent. It further pointed out that in over-the-counter securities transactions executed on an agency basis, a comparable commission is charged, and that when "the dealer acts as principal", the commission is usually between 2 and 3 percent and is limited by NASD rules to not more than 5 percent in almost all transactions. As has already been indicated, Congress refused to impose a 5 percent ceiling. Indeed, because of a concern that had been expressed, the Commission made it clear that it would not simply invoke its rule making power under Section 22 (b) as a means of achieving the same 5 percent ceiling.[66]

In the face of this legislative record, appellant's complaint is that there is an absence of competition from sec-

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[66] 1969 House Hearings, pp. 182-183, 214-215, 917-918.

ondary markets (J.A. 10) and that the Congress intended that the antitrust laws apply to the sales charges for a brokerage segment of mutual fund sales in the secondary market. The consequence of appellant's argument is that the Congress which sought to assure "reasonable compensation . . . for broker-dealers" not dictated by the competition of the marketplace, and which even refused to impose a 5 percent ceiling on sales charges, in either the primary distribution or in the secondary market, nevertheless intended that the competition of the antitrust laws should come into play on sales loads in one brokerage segment of the secondary market and even compel, as it could, a 5 percent, or still lower, sales charge. There is no basis whatever in the extensive legislative record referred to earlier for ascribing this intent to Congress. It is not necessary to reach the question whether the Commission, which is charged with the statute's administration, may effect this same result as a regulatory matter. The question here is whether the Congress intended that this result be obtained through the application of the antitrust laws.

As already indicated, the Senate Committee in its report stated (p. 8) that it had considered repealing Section 22 (d),[67] but that there was impressive testimony that there had not been sufficient study of the consequence of repeal. The committee requested the Commission to prepare a report on such consequences to "both the investing public and the mutual fund sales organizations" (p. 8). The Commission staff prepared such a report which did not make any express recommendations.[68] Before making any definitive recommendations the Commission decided to

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[67] In fact, it had done so in preliminary executive action. 1969 Senate Hearings, p. 19.

[68] *Report of the Staff of the Securities and Exchange Commission on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* (November 1972).

hold public hearings on the subject,[69] at which appellant appeared to urge competition and legislative repeal.[70] On November 4, 1974, the Commission released a staff report embodying recommendations,[71] which the Commission is now implementing, as will be discussed below. Meanwhile, to implement the provisions of the amended Section 22 (b), the NASD conducted extensive economic studies, which the Congress recognized would be necessary in view of the complexity of fund share pricing, and thereafter proposed rules which the Commission has cleared subject to certain modifications.

D. Administrative Precedent and the Secondary Market

We now turn to an analysis of the seeming statutory interstice from which appellant has shaped an approach that contradicts the Congressional intent and plan just described.

Section 22 (d) uses the term "dealer" and makes no reference to a "broker".[72] The axis of appellant's formulation is a Commission interpretation of Section 22 (d), first announced in 1941 as an opinion of its general counsel.[73]

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[69] In the Matter of Mutual Fund Distribution and the Potential Impact of the Repeal of Section 22 (d) of the Investment Company Act of 1940, File No. 4-164.

[70] *Ibid.*, pp. 2019 ff.

[71] *Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940* submitted by Division of Investment Management Regulation (August 1974).

[72] Mutual fund shares are not traded on stock exchanges, where all public trading is done in brokerage transactions. The Commission Investment Trust Study pointed out that a few issues of mutual funds had been listed on stock exchanges for the purpose of facilitating compliance with the "Blue Sky" laws of particular states, but that there never was any active trading on the exchanges. The absence of stock exchange trading was explained by the redemption features of mutual fund shares. Pt. 2, pp. 241-242, 281.

[73] Investment Company Act Release No. 87 (March 14, 1941).

Under this interpretation if a dealer is in any way involved in a sale to an investor, even though there may be an intermediate broker, and whether the broker is acting for the dealer or for the customer or for both, the prohibition of Section 22 (d) applies; it does not apply to a transaction in which one investor sells to another investor through a dealer "acting solely in the capacity of agent", i.e., broker.[74] This interpretation as to the pure brokerage transaction is the springboard for appellant's approach, although appellant reads more into it than was intended, as will later be shown.

As appellant views the matter, and this is the premise of its statutory analysis, the "broker" was omitted from the Section 22 (d) prohibition because he is "not a principal party" but is an "intermediary between buyer and seller" (Br. 23). Appellant proceeds from the incorrect premise that a securities firm in acting as "principal" or as "broker" necessarily has different roles, and that only when a firm acts as broker does it serve as "an intermediary between buyer and seller". A securities firm may or may not carry an inventory of shares, and if it does not, which is generally the case of a firm acting only as a retailer, it performs the identical intermediary function in a transaction between a buying investor and selling investor whether it acts as principal or as broker, a matter which it decides in the existing circumstances, unless it is otherwise contractually committed. Thus, for example, if a firm should happen to have simultaneously orders from one customer interested in sell-

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[74] This interpretation did not use the statutory definition of the term "dealer", which is defined in Section 2 (a) (11) of the Act to mean "any person regularly engaged in the business of buying or selling securities for his own account, through a broker or otherwise . . .". The general counsel took the position, without explanation, that "the term 'dealer', as used in Section 22 (d), refers to the capacity in which a broker-dealer is acting in a particular transaction."

ing and from another desirous of buying, and the orders can be matched in quantity of shares and in terms of execution, including price—the situation to which appellant addresses itself—the firm may, at its option, act as principal and simultaneously buy from one customer and sell to the other customer, or it can act as agent or broker for both customers. Thus, appellant's explanation of the statute in terms of difference in the "intermediary" function and market role of the "principal" and the "broker" is misconceived.

Proceeding from its misconception, appellant urges that whether the Investment Company Act or the antitrust laws governs the transaction between investors depends upon the form that the transaction takes. It is in effect argued that Congress drew a line predicated on the happenstance of form. Which statute applies, under appellant's approach, would depend upon the choice made by the intermediary securities firm as to the capacity in which it elects to act in effecting the transaction between customers, i.e., as principal or as agent. Under appellant's view, if the firm chooses to act as principal, the antitrust laws do not apply; the Investment Company Act and its overall regulatory pattern prevail. On the other hand, if the firm elects to act as agent, the antitrust laws are triggered and the Investment Company Act evaporates. Voluntary choice of capacity is thus the predicate of appellant's approach. This artificial and tenuous hypothesis with its preoccupation with form becomes the touchstone and is dispositive in determining which statutory regimen is applicable. Appellant proceeds from the premise, for which there is no basis as we have already shown, that a dichotomy between the Investment Company Act and the antitrust laws was intended as to a brokerage transaction between investors.

We are mindful, of course, of the fact that the fortuitous circumstance of capacity has been of moment to the Com-

mission in its interpretation of Section 22 (d).[75] However, it does not follow—and this is appellant's fallacy—that the Commission's interpretation, because it is relevant to the Investment Company Act, is therefore also relevant in determining the wholly unrelated question of the applicability and preemption of the antitrust laws. The Commission is charged with the administration of the Investment Company Act, including its retail price maintenance provision. Accordingly, it may adopt an interpretation in the context of that statute which it deems consistent with the statute's purpose and regulatory plan. But such interpretation by itself, even though it may be hospitable to some competition, does not for that reason catapult the matter into the antitrust arena and withdraw it from the embrace of the pervasive regulatory pattern of the Investment Company Act, which committed the matter of sales charges to the Commission's jurisdiction.

In any event, the language of Section 22 (d) and also the 1941 general counsel opinion must be considered in the context of the secondary market in mutual fund shares as it existed at the time the Act was passed. The Commission's Investment Trust Study that led to the statute initially characterized the "bootleg market" as an " 'inside' trading market."[76] The Study made certain observations about the secondary market in mutual fund shares on the basis of an analysis of four weeks of trading, which was considered fairly typical.[77] The study pointed out that "the sum total of trading includes primarily transactions: (1) between customers and retail dealers, (2) among retail

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[75] It might well be argued that the Commission's interpretation, in terms of the policy of Section 22 (d), is also vulnerable to criticism for parallel reasons, although it apparently does not view it as such.

[76] Pt. 2, p. 241, n. 100.

[77] Investment Trust Study, Pt. 2, p. 324.

dealers themselves, (3) between the retail dealers and the principal distributor or 'trading firms', (4) among the 'trading firms', and (5) between the 'trading firms' and the principal distributors."[78] These "trading firms", which were relatively small in number, traded with retail dealers, principal underwriters, and among themselves, but not generally with the public so that their trading was "really 'wholesale' in character."[79]

The Study further pointed out that the "reporting firms acted as principals rather than as brokers in practically all transactions."[80] Although the Study does not explain the matter, in view of the nature of the over-the-counter markets, as discussed below, it would appear that these brokerage transactions would have involved a retailer buying for a customer from a dealer, a transaction which would since 1940 be reached by Section 22 (d).

An indispensible ingredient of the over-the-counter markets are the so-called "market makers", who in effect serve as conduits and make the over-the-counter markets viable. They buy and sell as principal for their own account and maintain inventories in the particular securities in which they make a market. When a customer expresses an interest in buying or selling a security to the securities firm with which he deals, that firm, whether it is acting as a dealer or broker, will ordinarily look to the market maker to obtain or dispose of the customer's securities, as the case may be. The market maker is what the Investment Trust Study called the "trading firm", which dealt with the retailer who serviced the public customer. Since the market maker is a dealer, any purchase from him by a public customer, even if made through a broker, is covered by Section 22 (d).

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[78] Pt. 2, p. 325

[79] Pt. 2, p. 325.

[80] Pt. 2, p. 327.

In other words, for all practical purposes, the secondary market in mutual fund shares at the time the statute was enacted was made up of dealer, and not brokerage, transactions. In this context appellant's emphasis (Br. 22-23) on the absence of a reference in Section 22 (d) to a "broker" is misplaced. The public acquired its shares either directly or indirectly from a dealer. Thus, in the existing mode of transactions, the dealer reference in Section 22 (d) provided the full sweep needed to achieve the price fixing objective of the statute which the industry sought and obtained.[81]

The secondary market for mutual fund shares since the passage of the Act has also been an inter-dealer market. As is pointed out in a 1972 Commission staff study referred to by appellant, "the inter-dealer firms do not deal directly with the public."[82] The secondary market since 1940 has diminished. This was, of course, the intended purpose of Section 22 (d). But, as the foregoing Commission staff study pointed out, the diminution has also resulted from

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[81] In view of the emphasis placed by appellant on the terms "broker" and "dealer" (Br. 22) it is interesting to note that, like the 1966 Commission report, the Commission Investment Trust Study (Part 3, pp. 857-859) used the term "dealer" in a generic sense to describe a securities firm engaging in over-the-counter business, and the capacity in which the dealer was acting was delineated by references to "the dealer acting as principal" and to "the dealer acting as agent." This is reflected as well in the 1969 Senate Report (p. 8), which speaks of the "dealer [that] acts as principal." The dealer in a primary distribution, as previously pointed out, can take down shares only for orders he has already received, and he is designated as a "dealer" solely for the purpose of insulating the issuer and underwriter from liabilities for his acts. The comparability of market function of the "broker" and "dealer" in the secondary market, where the firm has no inventory, has already been pointed out.

[82] See note 68, *supra.*, Part II, p. 293.

other independent factors which has brought that market to its present reduced state.[83]

The 1941 general counsel opinion was rendered in response to a request from the NASD, which it appears was prompted by inquiries from the non-contract dealers who fully appreciated the fact that Section 22 (d) was directed at them and were concerned with its sweep. The 1941 opinion gave them no solace. It advised in effect that all dealers, in whatever capacity they acted, were embraced by Section 22 (d) as long as the source of their shares was another dealer, which as already indicated, was the common situation. The exception for the purely brokerage transaction between two public customers, which appellant highlights, was therefore of little, if any, consequence. The transaction was at most a rarity. According to the recent Commission staff report, it is only the recent advent of computer technology, and certain large securities firms operating with branch offices, that may make possible the matching of buy and sell orders on a broad scale.[84] But, as will be pointed out, the permissibility of such transactions, in the Commission's view, requires circumscription "to help neutralize any adverse impact on the funds primary distribution systems", which is the statutory mandate that appellant rejects.

Neither the general counsel opinion, nor *Oxford Company* 21 S.E.C. 681 (1946), in which the Commission itself accepted its general counsel's view, made any reference to

[83] These included, for example, the disappearance of the redemption fee that mutual funds at one time charged and a lessening of the percentage of the sales load retained by the principal underwriter, which have both had the effect of reducing the spread between the redemption value of shares, and the price charged to retail dealers, thereby in turn reducing the non-contract dealer's incentive to seek out selling shareholders rather than purchase shares from the underwriter on a primary distribution. See note 68, *supra.*, Part II, pp. 290-294.

[84] See note 71, *supra,* at p. 108.

contractual obligations or their impact on the brokerage exception.[85] This matter was referred to, however, in a 1973 letter of a Commission staff officer quoted extensively by appellant (Br. 38, note 33). The letter (J.A. 247) which was written to an underwriter, refers to these earlier interpretations and states: "Accordingly, the Act does not prohibit a broker-dealer from acting as agent with respect to a client." But then the letter follows with a sentence which appellant omits that points up the relevance and indicates the overriding nature of any contrary contractual restrictions. The letter states: "It is not clear to me whether or not paragraph 3 of your Dealer Agreement prohibits such broker activity, but I assume that, if it does, you would waive the prohibition." (J.A. 247) Presumably if there were no waiver, the contractual prohibition would prevail. Certainly the contract was of moment. Otherwise there would have been no reason to refer to it.

If in fact it were the statutory policy that retail price maintenance was to be observed only in principal transactions and could not be required of contract dealers in a brokerage transaction, which is what appellant is urging, then contractual restrictions on brokerage transactions would contravene the statute itself and be invalid.[86] This is not the Commission's view, however. In connection with its current proposal to introduce a brokerage market, the Commission accepted the validity of such restrictions and has asked the NASD to adopt a rule that would ban them as discussed below.

It thus appears from the foregoing that the general counsel opinion and the subsequent references to it, were

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[85] The *Oxford* case stemmed from a unique holding that in the special circumstances presented the securities firm could only act as a broker and could not elect to sell shares to the customer as principal.

[86] Section 47 of the Act, 15 U.S.C., 80a-§46, provides for the "voiding" of contracts made in violation of the statute.

directed solely to the restrictions that arise by virtue of Section 22 (d) and not to those that emanate from contract.[87] More specifically, as here pertinent, Section 22 (d) defines and limits the price restraints on the non-contract dealer, whose price cutting led to the enactment of Section 22 (d), but the contract dealer may be restrained additionally by his contract.

The Commission's own recognition of its brokerage interpretation during the intervening years, and its viability, should also be considered in terms of an amendment to Section 24 (d) of the Investment Company Act. The amendment was enacted in 1954 in connection with a general overhaul, under Commission sponsorship, of the prospectus requirements of the securities laws. The prospectus is a fundamental and threshold investor protection; it is the statutory vehicle for informing the investor about his investment.

The amendment, as the Commission stated at the time of its enactment, in the case of mutual funds "requires the use of prospectuses in *all* transactions [i.e., both on the primary distribution and in the secondary market] so long as securities of the same class are currently being offered or sold by the issuer by or through an underwriter."[88] Yet, the recent Commission staff report, which recommended the introduction of a brokerage market, observed (note 71, *supra*, at p. 107, note 1): "It would not appear possible for the Commission to require brokers to deliver prospectuses in the case of all secondary market transactions, although

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[87] As the recent Commission staff report stated in this regard: ". . . there is no *statutory requirement* that the offering price in the prospectus be maintained in a brokered transaction". Note 71, *supra*, at p. 104.

[88] 20th Annual Report of the Commission, p. 2. See S. Rep. No. 1037, p. 20, H. Rep. No. 1542, p. 30, accompanying S.2846, all in 83rd Cong., 2d Sess. which embodied the 1954 amendments.

the broker would be required to do so . . . if he happened also to be a dealer of the fund being purchased." Thus, the 1954 amendment, although it was intended to provide all investors with a prospectus, is deficient to this purpose; it was apparently drafted on the premise that mutual fund shares were and would be traded in the secondary market on a dealer basis, and not a brokerage basis. Of course, there would be no reason to deny an investor the all important prospectus because he happens to deal with a security firm that has decided to act as broker rather than as principal. The result is a patent statutory incongruity.[89]

The operation of the administrative scheme is also peculiar as it relates to brokerage transactions. The Commission's Rule 22c-1 under the Investment Company Act, 17C.F.R. 270.2c-l, requires "forward pricing", i.e., net asset value must be computed after the receipt of a purchase order or a tender for redemption. The rule encompasses a dealer, with no reference to a broker. And mindful of this, the recent Commission staff report (p. 107, note 1) would in effect require the broker in the brokerage market now being proposed by the Commission to inform investors that they might not fare as well as they would if Rule 22c-1 did apply.

The foregoing makes it clear that the question of the brokerage transaction under the statute cannot be determined by a simplistic approach. The matter is complex. It has received varied treatment and, as previously pointed out, the brokerage exemption was even specifically negated by the Commission during the Congressional hearings that led to the 1970 amendments. The matter of the brokerage transaction can only be resolved in terms of overall statutory policy and purpose, and not by invoking an adminis-

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[89] In fact, a serious question could be raised as to the advisability of permitting a brokerage transaction without assurance that the investor will receive the threshold protection of a prospectus. Blind investment is not a bargain even if the sales charges are minimal.

trative interpretative rubric and even assigning it a breadth which was not intended.

While appellant treats the brokerage interpretation first enunciated in the general counsel opinion as the end of the matter—withdrawing the brokerage transaction from the embrace of the Investment Company Act and subjecting it to the antitrust laws—the Commission views the interpretation only as the beginning of the inquiry with respect to its statutory consequences and the regulation necessary to serve the statute's objectives, as is shown by its recent action to which we now turn.

E. The Recent Commission Report

On November 4, 1974, the Commission released its staff report entitled *"Mutual Fund Distribution and Section 22(d) of the Investment Company Act."* This, in turn, was followed by a Commission letter of November 22, 1974, to the NASD designed to implement a recommendation as to brokerage transactions contained in the report.

The letter pointed out that "although the Rules of Fair Practice do not require that agreements between fund underwriters and broker-dealers contain such requirements", the Commission was requesting the NASD to amend its rules "to prohibit its members from being parties to agreements which restrict broker-dealers, acting as agents, from matching orders to buy and sell fund shares in a secondary market at competitively determined prices and commission rates." The Commission observed that "it believes that sound regulatory policy dictates the elimination of any such restrictions". The staff report had pointed out that if the NASD declined to amend its rules, the Commission could effect the same result by acting under Section 22 (f) of the Act or Section 15 (c) (2) of the Securities Exchange Act of 1934 (p. 105, note 1).[90]

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[90] Section 15 (c) (2) authorizes the Commission to adopt rules to prevent any fradulent, deceptive, or manipulative act or practice, or the making of any fictitious quotation.

The staff report in making the recommendation for "matched orders" had pointed out (p. 105) that "[w]hile it is difficult to predict the actual impact of a *limited* secondary brokered market for fund shares, we do not believe it would disrupt the primary distribution system", which as already pointed out, is the statute's concern. Because of this consideration the staff did not recommend a conventional brokerage market, nor is it contemplated by the Commission.

Thus, in its letter to the NASD, the Commission pointed out that "action in this area should also include steps to help neutralize any adverse impact on the fund's primary distribution system and to ensure that transactions in a brokerage market are in the interest of all the holders of the funds outstanding shares." To this end, the Commission, as the staff report had recommended, proposes to introduce innovation and restraint.

A novel fee will be permitted. The Commission stated that "funds would be permitted to impose reasonable service fees when ownership of their shares is transferred in this manner [i.e., through order matching]. In the absence of any underwriters' spread on the sale, such fees could include the cost of recording the transfer as well as an amount to compensate the underwriter, to some extent, for promotional purposes." In this regard the staff report had pointed out that "persons who buy and sell shares in the secondary market do benefit indirectly from the underwriter's services, for example, advertising, in that the underwriter helps to create the continuous demand which is basic to the functioning of such a market. Therefore, they should help pay the cost of such services" (p. 106, note 1).

Next, the Commission imposed a trading restriction. It stated: "To ensure that broker-dealers engage only in genuine matching of orders, they should not be permitted to fill orders to buy or sell fund shares more than one full business day after such orders are received." The staff re-

port characterized this as a "safeguard against the secondary brokered market functioning like a dealer market" (p. 107), and added that if necessary appropriate rules in this regard could be adopted by the Commission (p. 107, note 2).

Lastly, the Commission observed: "Nor should broker-dealers be required to set up special procedures to match orders for fund shares". The matter is wholly voluntary.

The staff report also observed that if a Commission rule under Section 22 (f) proved necessary to remove the contractual restrictions, it should contain a provision to exempt a fund that could show that the secondary brokered market presented a significant threat to its primary distribution system (p. 108).

The Commission's approach is, of course, completely at odds with the major premise of appellant's hypothesis. Appellant denies the statute's concern with the protection of the primary distribution system from the secondary market. To the Commission it is a central theme not only in the brokerage market, but also in the dealer market, where it did not require any contractual changes. There too, however, the Commission staff report, in addressing itself to possible future changes and legislative proposals, expressed its concern about protecting the primary distribution system (pp. 118-119).

The Commission's action proceeds from the premise of the propriety of contractual restrictions in sales agreements and its regulatory authority over these agreements. The Commission's action also demonstrates that the flat termination of these restrictions, which appellant urges under the antitrust laws, would contravene the policy of the Investment Company. Act. If contractual restrictions are to be eliminated, that statute, in the Commission's view, requires circumscription and continuing administrative oversight. The Commission's action is eloquent testimony to

the fact that the matter at hand is not one for resolution under the antitrust laws. There is present the "prerequisite conflict between the regulatory and antitrust schemes", which appellant states must be found (Br. 58). While the Commission has taken action that is hospitable to some competition, it has not tailored that action with competition alone in mind, as the antitrust laws would dictate. The Commission has tempered its action to meet a statutory objective, which is by its nature anticompetitive and alien to the antitrust laws.

Appellant's approach is thus simply an assault on the statutory regulatory plan and policy which contradicts the antitrust laws. As regards the Commission's authority to achieve and implement the statutory policy, the Investment Company Act suffers from no deficiency. We shall leave that articulation to the Commission for the brief which it is filing. What was intended, the Commission can accomplish. The statute is adequate to its task. The only question that need be decided here is whether the Congress intended that the antitrust laws apply to mutual fund sales charges. As shown earlier, this was not its intention.

CONCLUSION

For the reasons stated, the judgment of the district court dismissing the complaint should be affirmed.

Respectfully submitted,

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APPENDIX A

Section 15A of the Securities Exchange Act of 1934

Section 15A. (a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

(1) Such data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors; and

(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the "rules of the association."

Such registration shall not be construed as a waiver by such association or any member thereof of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section.

(2) such association is so organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section.

(3) the rules of the association provide that any broker or dealer who makes use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (4) or (5) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to or refuse to continue in such association any broker or dealer if—

(A) such broker or dealer, whether prior or subsequent to becoming such, or

(B) any person associated with such broker or dealer, whether prior or subsequent to becoming so associated,

has been and is suspended or expelled from a national securities exchange or has been and is barred or suspended from being associated with all members of such exchange, for violation of any rule of such exchange.

(4) the rules of the association provide that, except with the approval or at the direction of the Commission

in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if such broker or dealer—

(A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange or has been and is barred or suspended from being associated with all members of such association or from being associated with all brokers or dealers which are members of such exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade.

(B) is subject to an order of the Commission denying, suspending for a period not exceeding twelve months, or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or barring or suspending him from being associated with a broker or dealer.

(C) whether prior or subsequent to becoming a broker or dealer, by his conduct while associated with a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such broker or dealer, and in entering such a suspension, expulsion, or order, the Commission or any such exchange or association shall have jurisdiction to determine whether or not any person was a cause thereof.

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who, if such person were

a broker or dealer, would be ineligible for admission to or continuance in membership under clause (A), (B), or (C) of this paragraph.

(5) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such member. For the purpose of defining such standards and the application thereof, such rules may—

(A) appropriately classify prospective members (taking into account relevant matters, including type of business done and nature of securities sold) and persons proposed to be associated with members.

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members) of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the

training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association may adopt procedures for verification of qualifications of the applicant.

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (a) of section 32 of this title, be deemed an application required to be filed under this title).

(6) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

(7) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

(8) the rules of the association are designed to prevent fradulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

(9) the rules of the association provide that its members and persons associated with its members shall be

appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

(10) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and persons associated with members and the denial of membership to any broker or dealer seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include—

(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted.

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

(D) a statment setting forth the penalty imposed.

In any proceeding to determine whether a broker or dealer shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the broker or dealer or person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based.

(11) the requirements of subsection (c), insofar as these may be applicable, are satisfied.

(12) the rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be disseminated by any member or any person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations.

The provisions of this subsection, as in effect prior to the date of enactment of the Securities Acts Amendments of 1964, shall be applicable to the rules of any registered securities association which was registered on such date until July 1, 1964. After July 1, 1964, the Commission may, after notice and opportunity for hearing, suspend the registration of any such association if it finds that the rules thereof do not conform to the requirements of this subsection, as amended by section 7 of the Securities Acts Amendments of 1964, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

(c) The Commission may permit or require the rules of an association applying for registration pursuant to subsection (b), to provide for the admission of an association registered as an affiliated securities association, pursuant to subsection (d) to participation in said applicant association as an affiliate thereof, under terms permitting such power and responsibilities to such affiliates, and under such other appropriate terms and conditions, as may be provided by the rules of said applicant association, if such rules appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section. The duties and

powers of the Commission with respect to any national securities association or any affiliated securities association shall in no way be limited by reason of any such affiliation.

(d) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that—

(1) such association, notwithstanding that it does not satisfy the requirements set forth in paragraph (1) of subsection (b), will, forthwith upon the registration thereof, be admitted to affiliation with an association registered as a national securities association pursuant to said subsection (b), in the manner and under the terms and conditions provided by the rules of said national securities association in accordance with subsection (c); and

(2) such association and its rules satisfy the requirements set forth in paragraphs (2) to (10), inclusive, and paragraph (12), of subsection (b); except that in the case of any such association any restrictions upon membership therein of the type authorized by paragraph (3) of subsection (b) shall not be less stringent than in the case of the national securities association with which such association is to be affiliated.

(e) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a registered national securities association, the Commission shall revoke the registration of such affiliated securities association.

(f) A registered securities association (whether national or affiliated) may, upon such reasonable notice as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe. Upon the withdrawal of a national securities association from registration, the registration of any association affiliated therewith shall automatically terminate.

(g) If any registered securities association (whether national or affiliated) takes any disciplinary action against any member thereof or any person associated with such a member or denies admission to any broker or dealer seeking membership therein, or bars any person from being associated with a member, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (h), unless the Commission otherwise orders after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).

(h) (1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof or a person associated with a member, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant—

(A) finds that such member or person has engaged in such acts or practices, or has omitted such act, as the

association has found him to have engaged in or omitted, and

(B) determines that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association,

the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission determines that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

(3) In any proceeding to review the denial of membership in a registered securities association or the barring of any person from being associated with a member, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which such denial or bar is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; other-

wise, the Commission shall by order set aside the action of the association and require it to admit the applicant broker or dealer to membership therein, or to permit such person to be associated with a member.

(i) (1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember broker or dealer (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

(2) For the purposes of this subsection, the term "nonmember broker or dealer" shall include any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, who is not a member of any registered securities association, except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

(3) Nothing in this subsection shall be so construed or applied as to prevent any member of a registered securities association from granting to any other member of any registered securities association any dealer's discount, allowance, commission, or special terms.

(j) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy

thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

(k) (1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purposes of this title.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested, or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to—

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with members, or the qualifications required for members or natural persons associated with members or any class thereof.

(B) the method for adoption of any change in or addition to the rules of the association.

(C) the method of choosing officers and directors.

(D) affiliation between registered securities associations.

(l) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section.

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person—

(A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder.

(B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe,

was willfully violating with respect to such transaction any provision of such Act or rule or regulation.

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

(m) Nothing in this section shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail.

APPENDIX B

Pertinent Provisions of Section 22 of the Investment Company Act

Section 22. (a) A securities association registered under section 15A of the Securities Exchange Act of 1934 may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or surrendering for redemption any such redeemable securities in contravention of said rules.

(b) (1) Such a securities association may also, by rules adopted and in effect in accordance with said section 15A, and notwithstanding the provisions of subsection (b) (8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its

members from purchasing, in connection with a primary distribution of redeemable securities which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operating costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(2) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 15 (b) (10) of the Securities Exchange Act of 1934 as are appropriate to effectuate the purpose of this subsection with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 15 (b) (8) of that Act: *Provided,* That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(3) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970 (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule respecting excessive sales loads), the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 15A (k) (2) of the Securities Exchange Act of 1934.

(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on the date this subsection takes effect, the provisions of this subsection shall prevail.

(c) The Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any securities association, to the same extent, covering the same subject matter, and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members. Any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such

contain among its provisions such of the other requirements of this rule as the parties may deem pertinent or appropriate, but the failure so to include any such other requirement shall not exempt any transaction from the effect of this rule or any part thereof.

* * *

Withhold orders

(f) (1) No member shall withhold placing customers' orders for any such security so as to profit himself as a result of such withholding.

Purchase for existing orders

(2) No member shall purchase the securities of any open-end investment company of which it is the underwriter from such company except for the purpose of covering purchase orders already received and no member shall purchase such securities from the underwriter other than for investment except for the purpose of covering purchase orders already received.

* * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA,
Appellant,

v.

NATIONAL ASSOCIATION OF
SECURITIES DEALERS, INC., *et al.*,
Appellees.

On Appeal From The United States District Court for the District of Columbia

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BRIEF FOR APPELLEES BACHE & CO. INCORPORATED, DEAN WITTER & CO. INCORPORATED, DUPONT GLORE FORGAN INCORPORATED, HORNBLOWER & WEEKS-HEMPHILL NOYES INCORPORATED, E. F. HUTTON & COMPANY INC., MERRILL LYNCH, PIERCE, FENNER & SMITH INC., PAINE, WEBBER, JACKSON & CURTIS INCORPORATED, AND REYNOLDS SECURITIES INC.

This is an appeal from a judgment dismissing appellant's antitrust complaint. In the opinion of the

District Court (J. App. 333-62),[1] reported at 374 F. Supp. 95, Section 1 of the Sherman Act, 15 U.S.C. § 1, as amended, does not forbid certain practices engaged in by the appellees in connection with the sale and pricing of the shares of open-end management investment companies ("mutual funds") because of (1) the requirements and provisions of the Investment Company Act of 1940, 54 Stat. 789, as amended, 15 U.S.C. §§ 80a-1 *et seq.* ("1940 Act"), and the Maloney Act of 1938, 52 Stat. 1070, 15 U.S.C. § 78o-3, and (2) the exclusive jurisdiction of the Securities and Exchange Commission ("SEC") to regulate the practices challenged.

This brief in support of affirmance of the District Court's opinion is filed on behalf of eight securities dealers who were included among the named defendants in appellant's complaint.[2]

STATUTES INVOLVED

Contrary to appellant's brief (J.B. 3-5), a great number of statutory provisions are involved and support the District Court's opinion. For the convenience

[1] In this brief, "J. App." refers to the Joint Appendix; "J.B." refers to the brief filed by the appellant, United States (Justice Department); and "Add." refers to the Addendum to this brief filed by the appellee dealers.

[2] A ninth dealer defendant, Walston & Co., Inc., is in bankruptcy and subject to court order enjoining the continuance of lawsuits against it. The naming of these nine securities dealers as defendants was arbitrary or fortuitous, since hundreds of securities dealers are parties to the standard mutual fund sales agreements, publicly filed at the SEC, which are the principal remaining issue in this case, following appellant's abandonment in the District Court of its attack on the rules of the appellee National Association of Securities Dealers ("NASD"). See pages 19-20, *infra*. The appellee dealers are members of the NASD.

of this Court, the principal provisions of these statutes are set forth in the Addendum to this brief.

QUESTIONS PRESENTED

The question presented by this appeal is whether the District Court was correct in dismissing appellant's complaint upon the basis of its affirmative answers to the following three questions:

1. Does Section 22(f) of the Investment Company Act, by expressly sanctioning those transferability restrictions in mutual fund distribution contracts which are fully disclosed to and not disapproved by the SEC, thereby immunize such restrictions from antitrust attack?

2. Does Section 22(d) of the Investment Company Act, by requiring resale price maintenance in the sale of mutual fund shares (under sanction of criminal penalty), thereby immunize those who obey the statutory command from antitrust attack?

3. Do the Investment Company Act and the Maloney Act, by granting the SEC exclusive jurisdiction to permit or prohibit restrictions on the manner in which mutual fund shares are sold and redeemed, to control the industry self-regulatory activities of the National Association of Securities Dealers ("NASD"), and to regulate the flow of mutual fund market information to dealers and the public, thereby immunize those who comply with SEC regulation from antitrust attack?

COUNTERSTATEMENT OF THE CASE

1. The Nature and Distribution of Mutual Fund Shares [3]

An "investment company" invests in securities issued by other persons and issues securities of its own, usually in the form of common stock representing proportionate shares of the company's portfolio assets. An "open-end" investment company, popularly called a "mutual fund," continuously issues and sells new shares which, by law,[4] it must redeem upon the holder's demand.[5] These two features—continuous, unlimited distribution and compulsory redemption—are, as this Court recognized recently in *United States* v. *Cartwright,* 411 U.S. 546, 547 (1973), the "unique characteristic[s]" of mutual fund shares, radically distinguishing them from conventional corporate securities.

A mutual fund which sells its shares without imposing a sales charge or "load" is a "no-load fund." The present case, however, concerns the shares of three "*load* mutual funds," by far the most common

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[3] See generally SEC, Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 4, 88th Cong., 1st Sess. at 95-99, 102-113 (1963) ("1963 Special Study"); SEC, Report on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2nd Sess. at 33-59, 201-50 ("1966 Public Policy Report"); SEC, Staff Report on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, Pt. I in F. Sec. L. Rep. Report No. 450, Pt. II (1972) ("1972 Section 22(d) Report, Pt. I").

[4] Section 22(e) of the Investment Company Act ("1940 Act"), 15 U.S.C. § 80a-22(e).

[5] A company which has outstanding, but is no longer issuing, such redeemable securities is a "closed-up" open-end company. An investment company which does not have outstanding, and is not currently offering, redeemable securities is a "closed-end" company.

type of mutual fund. To sell its shares, a load fund invariably enters into a distribution arrangement with a principal underwriter. That arrangement must, by law, be embodied in a written contract[6] filed at the SEC. Some principal underwriters maintain their own "captive" sales forces. The three appellee underwriters here, however, employ independent broker-dealers, including the appellee dealers named in this suit. Each underwriter has its own distinct contract form which, under an SEC-approved NASD rule,[7] a broker-dealer must sign before he can sell the particular fund's shares. Like the fund-underwriter contracts, these underwriter-dealer or "selling group" agreements must, by law, be filed with the SEC.[8] While each appellee underwriter is an exclusive wholesale distributor for a particular group of funds, each appellee dealer is a party to the selling group agreements of many competing funds and fund groups.

Investors obtain fund shares either by reinvesting dividends and capital gain distributions earned from their existing fund shares, by switching from one fund to another in the same group of related funds, and by purchasing directly from contract dealers. The first two types of purchases are usually at no load. Purchases from dealers are at an established "load" and are made pursuant to a "contractual plan," or in accordance with a "voluntary accumulation plan," or in a single, lump sum.[9]

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[6] Section 15(b) of the 1940 Act, 15 U.S.C. § 80a-15(b).

[7] Rule 26(c), Art. III, § 26(c) of the NASD Rules of Fair Practice, CCH Manual ¶ 2176 (1974) ("NASD Rules").

[8] See page 91, *infra*.

[9] Under the contractual or "periodic payment" plan, the investor purchases a certificate issued by a "unit investment trust." The

As soon as a recently proposed NASD sales load rule (already tentatively approved by the SEC) takes effect, the maximum permissible sales load for mutual fund shares will be 8.5% of total payments. Even a lower ceiling will apply if the fund does not offer volume discounts, accumulation rights, and dividend reinvestments at no load. At the present time, sales loads for purchases of less than $10,000 are typically 8.5%, or $85 on a $1,000 purchase. After the investor makes payment, the load is returned from the fund to the underwriter in the form of a discount on the underwriter's order. The underwriter keeps a small fraction of the load for promotional and prospectus-printing expenses. The remainder goes to the dealer for selling expenses and profit.

Pursuant to an SEC-approved NASD rule,[10] the contract dealer may not maintain an inventory of fund shares. Upon receiving a solicited or unsolicited order, the dealer communicates the order to the fund

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trust is, itself, an investment company with a portfolio consisting solely of shares in a specific underlying mutual fund. The investor pays in installments and, at any time, may redeem his certificate for cash or for the underlying fund shares to the extent of his payments. The investor pays a "front-end" load, *i.e.*, a charge for the total purchase to be made under the plan collected primarily from his initial installments. By law, the front-end load may not exceed 9% of the total payments to be made under the plan, and a somewhat higher percentage of the actual payments made on an uncompleted plan. 15 U.S.C. § 80a-27.

Under a voluntary accumulation plan, the investor buys fund shares directly by means of periodic purchases at established loads. If he does not complete the plan, he suffers no "front-end load" type of penalty. If he does complete the plan, his final installment may reflect a reduced sales load for the cumulative dollar value purchased. Similar volume discounts are usually available to lump-sum purchasers.

[10] Rule 26(f), NASD Rules.

or its underwriter for confirmation. At the close of the stock exchanges that day, the fund calculates the value of its portfolio and determines net asset value per share, as required by SEC rule.[11] Orders received prior thereto are confirmed at net asset value plus the applicable sales load established in the current fund prospectus. The sum of the net asset value and the load is the "public offering price" which Section 22(d) of the Investment Company Act[12] requires the investor to pay. The investor eventually receives a share certificate or some other evidence of ownership. To redeem, the investor either mails the certificate (or other evidence) directly to the fund or has a broker-dealer transmit it, usually at no charge. The redeeming investor receives net asset value calculated at the end of the day on which his redemption request is received.

2. The Only Real Market For Fund Shares

The just-described distribution-redemption system is commonly called the "*primary* market," although there has been virtually no *secondary* market in fund shares since the Investment Company Act was enacted in 1940. As this Court held in *United States* v. *Cartwright, supra,* 411 U.S. at 557, the only real market in mutual funds is the primary distribution-redemption "* * * market in mutual fund shares that the Act created and regulates." "Private trading in mutual fund shares is virtually non-existent." *Id.* at 549. There is, however, a "tiny *inter-dealer* market," not directly involving the public; it is, in the SEC's

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[11] 17 C.F.R. § 270.22c-1 (1974).

[12] 15 U.S.C. § 80a-22(d).

words, "an extremely miniscule affair, almost a mere curiosity." [13]

Except for this inter-dealer "curiosity," which accounted for less than one-tenth of one percent of total 1970 mutual fund share sales,[14] there is not, and has not been since the 1940 Act, a *secondary* market involving dealer sales to the public. Recognizing that Section 22(d) of the 1940 Act unquestionably prevents the development of a price-competitive secondary *dealer* market, the appellant's principal objective in this suit appears to be the creation of a cut-price "secondary *brokerage* market" for the transfer of fund shares after their initial primary sale to investors. Under the appellant's theory, broker-dealers (including regularly soliciting, primary market, contract dealers) would act as commissioned agents selling and buying fund shares for investors at prices between the estimated public offering price and the estimated net asset value.[15]

Aside from the question whether such a "brokerage market" of the scale hypothesized would even be legal under the Investment Company Act (see Argument at pages 42 to 86, *infra*), there is every reason

[13] 1972 Section 22(d) Report, Pt. I at A-112 to A-113. A few firms, maintaining markets in a very limited number of mutual funds, sell shares to non-contract broker-dealers for retail to their customers at the statutorily required public offering price. These inter-dealer market-makers also purchase shares from broker-dealers whose customers prefer immediate cash to the slightly slower redemption process. *Id.*

[14] *Id.* at A-113.

[15] The range would have to be estimated because, in primary distribution, net asset value is determined at the close of the day and applied retrospectively to that day's sales and redemptions. See 17 C.F.R. § 270.22c-1 (1974).

to believe that this imaginary entity would never be practicable.[16] Although mutual funds have been distributing redeemable shares since 1924,[17] no "secondary brokerage market" for those shares has ever developed, even on an intermittent, limited, or single-fund basis.[18] The appellant concedes "that no such brokerage [market] actually exists today." J.B. 10 n.12. The appellant's chief trial attorney in this case even told the SEC, "I don't know exactly how the brokerage market would in fact work."[19] Indeed, he not only did not know *how* the "market" would work, he really did not know *whether* it would work. Regarding what he called "the possibility for it [*i.e.,* the brokerage market] working," his reluctant conclusion was "I don't know * * *."[20]

3. History of the Investment Company Act

Mutual funds, their underwriters and dealers, have been subject to federal securities legislation since 1933. The Securities Act of 1933[21] ("1933 Act") prohibited

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[16] In the instant procedural setting, no doubt the complaint should be construed generally in the plaintiff's favor. Nonetheless, the complaint's description of this purely hypothetical, confessedly non-existent "brokerage market" does not make that market a fact, or make that market description "true" in any meaningful sense. Compare J.B. 6 n.4.

[17] Wharton School, A Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong., 2d Sess. at 4 (1962) ("Wharton Report").

[18] See page 74, *infra*.

[19] Hearings on Mutual Fund Distribution and the Potential Impact of the Repeal of Section 22(d), SEC File No. 4-164, Tr. at 2081 (1973) (Mr. Hunter) ("1973 Mutual Fund Distribution Hearings").

[20] *Id.* at 2081-082.

[21] 15 U.S.C. §§ 77a *et seq.*

funds from issuing shares unless the shares were covered by a current registration statement on file at the SEC. The Securities Exchange Act of 1934[22] ("1934 Act") supplemented the 1933 Act's disclosure requirements and subjected broker-dealers (including those who distributed fund shares) to SEC registration and discipline. The Maloney Act of 1938, adding Section 15A to the 1934 Act,[23] authorized broker-dealers to organize SEC-registered national self-regulatory associations for comprehensive supervision of members' over-the-counter activities, including mutual fund distribution, subject to ultimate SEC oversight. The appellee National Association of Securities Dealers ("NASD") is the only Maloney Act association ever formed.

As early as 1935, Congress acknowledged that the existing federal legislation did not begin to address the multiplicity of regulatory problems unique to the investment company industry. Congress directed the SEC to study investment companies, including mutual funds, with a view to further legislation.[24] The SEC conducted an exhaustive study and submitted to Congress over a four-year period a massive, multi-part report known as "The Investment Trust Study."[25]

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[22] 15 U.S.C. §§ 78a *et seq.*

[23] 15 U.S.C. § 78o-3.

[24] Section 30 of the Public Utility Holding Company Act, 15 U.S.C. § 79z-4.

[25] Investment Trust Study, Pt. One, H.R. Doc. No. 707, 75th Cong., 3rd Sess. (1938) ("Investment Trust Study, Pt. One, H.R. Doc. No. 707"); Pt. Two, H.R. Doc. No. 70, 76th Cong., 1st Sess. (1939) ("Investment Trust Study, Pt. Two, H.R. Doc. No. 70"); Pt. Three, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1940) ("Investment Trust Study, Pt. Three, H.R. Doc. No. 279"). There were

Among other things, the Study confirmed the existence of an active secondary market in mutual fund shares, popularly known as "the bootleg market," which was the equal of the authorized primary market in sales dollar volume. This "bootleg market," operated principally by non-contract dealers, was severely disrupting the primary market by competing against it in price and by fostering discrimination among investors.[26]

The SEC also produced a draft investment trust bill authorizing detailed regulation of funds, underwriters, and dealers.[27] After industry leaders testified before a Senate subcommittee in strong opposition to parts of the bill, the SEC and the industry were asked to formulate a compromise measure. Their substitute bill, developed through lengthy negotiations, was enacted. This Investment Company Act of 1940, 54 Stat. 789, 15 U.S.C. §§ 80a-1 *et seq.,* contained key provisions urged by the industry.[28]

Under the enacted compromise, unlike the first bill, the NASD was given initial responsibility for regulating sales loads and distribution practices (Sections 22(a) and 22(b)),[29] and the SEC was empowered to supplement and supersede where necessary (Section 22(c)).[30] Another provision from the original SEC

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several supplemental reports, as well. See H.R. Doc. Nos. 380, 476, 477, 482, 567, 659, 76th Cong. (1939-41).

[26] See pages 26 to 30, *infra.*

[27] In addition, the SEC drew up companion legislation which became the Investment Advisers Act of 1940, as amended, 15 U.S.C. §§ 80b-1 *et seq.*

[28] See pages 32, 53-59, *infra,* for the detailed history.

[29] 15 U.S.C. §§ 80a-22a) and 80a-22(b).

[30] 15 U.S.C. § 80a-22(c).

draft was rewritten to clearly sanction the restrictions upon transferability which funds had been using to combat the "bootleg market." As redrafted, this provision—Section 22(f)[31]—said that such restrictions, would continue to be lawful, provided that they are disclosed in the funds' registration statements, unless and until contravened by SEC rules and regulations. In addition, at the industry's suggestion, an entirely new provision—Section 22(d)—was added. Section 22(d) prohibited the sale of mutual fund shares to the public, whether in a primary or a secondary market, at any price less than the applicable public offering price fixed in the fund's prospectus. Violation of Section 22(d)'s price-maintenance requirement was made a federal felony.

From 1967 to 1970, Congress, relying heavily upon extensive SEC studies and testimony, comprehensively reviewed the 1940 Act. Congress considered the SEC's proposal of a 5% sales load ceiling, subject to continuing SEC control. It weighed the Justice Department's counter-proposal that Section 22(d) be repealed so that each fund's shares would be open to price competition in primary and secondary markets. In its Investment Company Amendments Act of 1970,[32] Congress rejected both proposals. Congress fully reenacted Section 22(d) with a mere technical amendment. Congress amended Section 22(b) so as to strengthen the NASD's authority to promulgate reasonable sales load rules, subject to SEC alteration, and explicitly stated therein that such rules "shall allow for reasonable compensation for sales personnel,

[31] 15 U.S.C. § 80a-22(f).

[32] Pub. L. No. 91-547, 84 Stat. 1314.

broker-dealers, and underwriters * * *."[33] Congress expressly exempted this NASD-SEC regulation of sales loads from antitrust scrutiny.[34] Congress retained Section 22(f) in full, thus continuing to sanction transferability restrictions which are disclosed in registration statements and not prohibited by the SEC.

4. Pervasive SEC Regulation of Mutual Fund Sales and Pricing

The 1940 Act and its companion federal securities laws constitute a particularly "thoroughgoing statutory scheme to govern mutual funds."[35] No other issuers of securities are subject to such pervasive regulation, both directly and through their underwriters and dealers.[36] A complex matrix of statutory provisions, rules, regulations, and orders, makes this perhaps the most governmentally controlled industry to appear before this Court in an antitrust context.

The regulatory scheme with respect to the matters generally at stake in this case—sales, pricing, restrictive agreements, and investor information—is especially pervasive. There is extensive regulatory control over the content of documents filed with the SEC, intensive SEC supervision of NASD rulemaking, and elaborate rulemaking by the SEC itself.[37]

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[33] 15 U.S.C. § 80a-22(b)(1), as amended.

[34] 15 U.S.C. § 80a-22(b)(4).

[35] Letter, Ray Garrett, Jr., SEC Chairman, to Senator John Sparkman, Chairman of the Senate Committee on Banking, Housing & Urban Affairs, Nov. 4, 1974, transmitting the SEC Staff Report, Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940 at v (August, 1974) (hereinafter "1974 Mutual Fund Report").

[36] *Id.*

[37] The details are described at pages 90 *et seq.*, *infra*.

Since before 1940, the very distribution agreements whose allegedly restrictive provisions form the crux of this lawsuit have been fully disclosed to the SEC in annual registration statements and periodic reports thereto. NASD Rule 26(c), since its approval by the SEC in 1941, has required dealers to become parties to such agreements before they could legally engage in any primary distribution of fund shares to the public. At all times, the SEC has had the power to alter or supplant Rule 26(c), pursuant to Section 22(c) of the 1940 Act, and also to issue rules and regulations under Section 22(f) of that Act prohibiting or limiting the alleged restrictions upon transferability in the publicly filed distribution agreements required by Rule 26(c).

Moreover, since 1940 the SEC has had the authority under Sections 6(c) and 38(a) of the Act[38] to issue broad exemptive rules, regulations, or orders to relieve regularly soliciting contract dealers from the challenged restrictive agreements and from the price maintenance mandate of Section 22(d). With the possible exception of a calculatedly limited rule permitting quantity discounts in primary market distribution, the SEC has chosen as a matter of conscious regulatory policy not to alter the basic system created by Section 22(d), Rule 26(c), and the distribution agreements. The SEC has intentionally protected the primary distribution system from competitive pressure and discriminatory pricing.

Over the last several years, at the specific request of Congress, the SEC has comprehensively reexamined its past policies with respect to the pricing and sale

[38] 15 U.S.C. §§ 80a-6(c) and 80a-37(a).

of mutual fund shares. In 1972, the Commission's staff compiled a massive study of Section 22(d) of the Investment Company Act and the economic impact which repeal of that provision might cause.[39] In several weeks of public hearings in early 1973,[40] the SEC heard testimony from approximately seventy persons and received more than a hundred written comments about the effects of Section 22(d), the desirability *vel non* of competition in the mutual fund industry, and related aspects of mutual fund distribution.

In November 1974, the Commission transmitted to Congress a report prepared by the SEC's Division of Investment Management and the SEC's own proposed "program" for major changes in the mutual fund industry.[41] The letter of transmittal flatly rejected the drastic infusion of competition which the Justice Department has persistently urged in statements to Congress, in comments and testimony to the SEC, and in pleadings in this case:

> As a general policy, the Commission believes it appropriate to promote efficiencies in securities distribution through retail price competition. However, implementation of this policy in the distribution of mutual fund shares is not an easy task. Simply stated, *it is our judgment that neither the industry nor the investing public would benefit from the disruption that might arise upon immediate repeal of Section 22(d).* Accordingly, the Commission does not recommend such a drastic step. Instead, we intend to exercise our

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[39] 1972 Section 22(d) Report.

[40] 1973 Mutual Fund Distribution Hearings.

[41] 1974 Mutual Fund Report.

available administrative authority to encourage the industry to move toward competition.[42]

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For more than three decades, the marketing strategy of the mutual fund industry has been to rely almost exclusively upon a sales "push" rather than a demand "pull;" or, as is often said, fund shares are "sold, not bought." In this environment, *it would be unrealistic to suppose that a sudden end to retail price maintenance would be accompanied by the level of investor sophistication and sensitivity to sales loads that would be needed to make a price competitive distribution system work. The more likely result of a precipitous end to retail price maintenance would be an end to widespread distribution of mutual fund shares, and most Americans would not have an opportunity to consider investing in mutual funds. As a consequence, many mutual funds—which by their nature tend to be self-liquidating and, therefore, require continuous distribution—would be adversely affected.*[43]

* * *

Therefore, the Commission has chosen a middle path, intended to reduce or eliminate many of the inequities and inefficiencies of the present fund distribution system while, at the same time, avoiding the dangers of a sudden abolition of retail price maintenance. *We have decided to exercise fully our existing administrative powers to lay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system.*

The Commission's aim is to allow the industry to adopt voluntarily programs designed to set

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[42] *Id.* at ii (emphasis added).

[43] *Id.* at v (emphasis added).

the stage for retail price competition.[44]

As a first step in discovering whether and when full-scale price competition can be safely implemented, the SEC plans to experiment with price flexibility in two areas. It is revising its "traditional administrative positions" and "past restrictive Commission interpretations" under Section 22(d) to allow lower loads to specially situated groups and individuals buying in the primary market.[45] The SEC is also asking the NASD to amend its Rule 26 so that underwriter-dealer agreements do not prevent dealers from engaging in "genuine matching" of buy and sell orders in a limited secondary "brokered" market.[46] In this latter connection, the SEC fully intends to exercise its broad authority under Section 22(f) of the Investment Company Act to forbid contract restrictions which impede dealer participation in the limited "matching" market.[47] Nonetheless, by various regulatory "safeguards" the Commission fully expects to keep this limited "matching" from developing into a sizeable market that would impose substantial competitive threats on the statutorily protected primary distribution system.[48]

5. The History of This Litigation

On February 2, 1973, the Justice Department filed lengthy written Comments in the SEC's Mutual Fund

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[44] *Id.* (emphasis added).

[45] *Id.* at iv, vi.

[46] Letter from Ray Garrett, Jr., SEC Chairman, to Gordon S. Macklin, NASD President, November 22, 1974, reprinted in Addendum hereto at Add. 18 ("Garrett letter").

[47] 1974 Mutual Fund Report at vi, 105, 105 n.1, 106, 109.

[48] *Id.* at 105, 107, 108, 109.

Distribution Hearings.[49] While urging the legislative repeal of the resale price maintenance system mandated by Section 22(d), the Department said:

> Furthermore, we believe that the Commission has the power under § 6(c) of the Investment Company Act to eliminate the adverse effects of the resale price maintenance provisions of § 22(d) and need not wait for repeal. We urge the Commission to use this power. [Comments 2-3.]

The Justice Department also dealt with the suggestion that, even if Section 22(d) were repealed, the funds would be able to forestall a price-competitive secondary market by restrictions on dealers' rights to redeem shares. The Department dismissed this problem by observing:

> However, the Commission could eliminate such difficulties, if they arise, by promulgating regulations prohibiting unreasonable restrictions on transferability pursuant to § 22(f) of the Investment Company Act. [Comments 13-14.]

In short, immediately prior to the lawsuit, the Department of Justice publicly recognized that resale price maintenance for mutual fund shares was mandated by Section 22(d) and that, even absent legislative action, the SEC had adequate statutory authority under Section 6(c) and Section 22(f) to deal with restraints on competition in the distribution of mutual fund shares.

On February 21, 1973, the Department, despite its written presentation in the SEC hearings less than three weeks earlier, filed this civil antitrust suit,[50]

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[49] Comments of the Dept. of Justice, SEC File No. 4-164.

[50] Subsequent to the appellant's suit, some fifty private, treble damage, class actions based on similar allegations were commenced

alleging that long-existing, publicly acknowledged contractual restrictions concerning the manner in which mutual funds are sold and priced violate Section 1 of the Sherman Act, 15 U.S.C. § 1. Counts II through VIII attacked alleged restrictions on the sale of mutual fund shares, as set forth in the fund-underwriter and underwriter-dealer agreements annually filed in the funds' registration statements at the SEC. Count I challenged the legality of various NASD rules and regulations and alleged a horizontal conspiracy of the NASD and its members to stifle the development of a secondary "brokerage market" or secondary dealer market outside the statutorily price-fixed primary distribution system.

The District Court determined that it would first examine the basic, legal question whether the Investment Company Act exempted the alleged conduct from antitrust attack. At oral argument on defendants' motion to dismiss, the appellant apparently abandoned its attack on the NASD's rules. J. App. 328-32. Thereafter, the General Counsel of the SEC advised the court of the Commission's grave concern

in various federal district courts and transferred to the District of Columbia by the Judicial Panel on Multidistrict Litigation. One class action had been filed in the District of Columbia in December 1972, largely anticipating the theories advanced in the appellant's case. That and one other case were dismissed by the District Court at the same time that it dismissed the appellant's complaint herein. Appeals of those two cases to the U.S. Court of Appeals for the District of Columbia Circuit were stayed pending resolution of this appeal. The plaintiffs in one of those cases petitioned this Court for a writ of certiorari before judgment in the court of appeals, purportedly pursuant to this Court's Rule 20. That petition was denied, *Gross* v. *National Ass'n of Securities Dealers, Inc.*, 43 U.S.L.W. 3209 (U.S. Oct. 15, 1974). The remaining private actions have been stayed by the District Court pending the three appeals.

that the suit might involve an attack on the rules of the NASD "over which the Commission is granted exclusive original jurisdiction by Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3, *et seq.* (the Maloney Act)." J. App. 323. Prior to the District Court's decision, the appellant confirmed its abandonment of those portions of Count I of its complaint which attacked NASD rules. J. App. 327.[51] On December 14, 1973, the District Court entered final judgment granting the appellees' motions to dismiss the appellant's complaint on the grounds identified in the Questions Presented (page 3, *supra*).

SUMMARY OF ARGUMENT

The Investment Company Act of 1940 created a pervasive scheme of SEC regulation over the sale and redemption of mutual fund shares. By that Act, Congress expressly substituted a system of mandatory resale price maintenance, coupled with protections against excessive sales charges, in place of "intra-brand" price competition in the sale of a single fund's shares. As an integral part of the price maintenance system, Congress also expressly authorized the mutual fund industry to employ contractual restrictions on the transferability of fund shares, provided that such restrictions are disclosed in SEC registration statements and do not contravene SEC rules or regulations.

For thirty-five years the mutual fund industry has complied with the statute's price maintenance requirements and has imposed contractual restrictions on transferability which have been fully disclosed to,

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[51] It is difficult to follow this concession in appellant's brief. Compare J.B. 10-11 with J.B. 51.

and not prohibited by, the SEC. The entire distribution system, including the contractual restrictions, has operated under the daily scrutiny of the SEC and of the industry's Congressionally authorized self-regulatory body, the NASD. The NASD itself has operated under an umbrella of detailed SEC supervision and has supplemented the SEC's regulation of the most minute aspects of the sale, redemption, and pricing of mutual fund shares.

Prior to the filing of this lawsuit, appellant seemingly recognized that the price maintenance provisions of Section 22(d) of the Investment Company Act created a necessary exemption from the antitrust laws. Appellant further recognized that transfer restrictions in mutual fund sales agreements could be used to inhibit secondary market activities in fund shares and that the SEC had statutory authority under Section 22(f) of the Act to regulate the use of such restrictions. Indeed, appellant went so far as to contend that the SEC, through its exemptive power under Section 6(c) of the Act, could relieve industry members of their statutory price maintenance obligations.

The appellant, notwithstanding its prior acknowledgment of the SEC's jurisdiction, has recently tired of its efforts to interject greater competition into mutual fund sales through appeals to the SEC for administrative action or to the Congress for legislative action. Rather, seizing upon an alleged loophole in the price maintenance requirement of Section 22(d), the appellant has launched an antitrust attack upon selected representatives of the mutual fund industry, contending that these long-standing, publicly disclosed practices are not only violations of Section

1 of the Sherman Act, 15 U.S.C. § 1, but *"per se"* violations to which the appellees can adduce no defense based upon the reasonableness of their conduct.

The ultimate defense, as the District Court recognized, is the appellees' good faith reliance upon the exclusive jurisdiction of the SEC. The appellant cannot have it both ways: contending or conceding for three decades that the SEC has the authority to regulate these practices, then asserting by this lawsuit that the same practices are irrebutable violations of the antitrust laws.

Having abandoned its initial attack upon the rules of the NASD, appellant's lawsuit is now basically an attack upon the restrictions contained in the distribution agreements between the funds and their principal underwriters and between the underwriters and the dealers. Even though the appellees' agreements are an integral part of the SEC-NASD regulation of fund distribution, and even though the NASD rules require the use of such agreements, the appellant still refuses to acknowledge the SEC's exclusive jurisdiction over these agreements.

The District Court was correct in concluding that Section 22(f) of the Act necessarily immunizes these agreements from a conflicting application of the antitrust laws. The literal language of Section 22(f) shows that transfer restrictions may be incorporated in these agreements, subject only to the requirement that they be publicly filed as part of the fund's registration statements and not be in contravention of any SEC rules and regulations. The history of the Act further demonstrates that transfer restrictions aimed against the disruptions of the secondary market

were specifically the sort of restrictions which the industry had used and wanted to continue, subject to SEC supervision.

The District Court was also correct in its conclusion that Section 22(d) was intended effectively to preclude price competition in the sale of a fund's shares. Congress made this policy decision knowing full well that it would frustrate the growth of a free secondary market for fund shares. There is nothing permissive about Section 22(d). It does not merely "authorize" a "limited" exception to the antitrust laws. Thus, it is not analogous to "fair trade." What Section 22(d) does is to order that the fixed public offering price must be maintained by designated types of persons who might otherwise be in a position to disrupt the continuous, primary distribution system: the "principal underwriter" and both the contract and noncontract "dealer." Further, nothing in the history of Section 22(d) suggests that persons bound by its pricing requirements could evade the statute by the mere expediency of soliciting "brokerage transactions" in fund shares in a secondary market. Such activities would have been as disruptive of the primary distribution effort as the specific price-cutting secondary dealer market which Section 22(d) was designed to curtail. Even if the application of Section 22(d) were ambiguous, persons meeting the statutory definition of "dealer" would be ill-advised to "sell," *i.e.,* engage in any effort to sell, at other than the statutorily fixed price. The penalties for failure to comply with Section 22(d) are criminal.

Congress was reminded of this significant exception to the antitrust laws in its review of the Act in the late 1960's; but Congress elected to reenact Section 22(d). The legislative solution to the charge that

Section 22(d) fostered high sales loads for mutual funds was not repeal, but rather the placing of still greater regulatory authority in the NASD and the SEC through the Investment Company Amendments Act of 1970.

Today the SEC unquestionably has broad authority over the mutual fund industry. Appellees do not need to make an overblown assertion of antitrust immunity for all possible trade restraints relating to mutual funds. To affirm the lower court's decision, it is sufficient that the acts and practices which appellant has actually put in issue fall clearly within the SEC's jurisdiction. While Section 22(f) should in itself be a sufficient rebuttal to these allegations, the lower court properly noted that the SEC's jurisdiction is further confirmed by the entire statutory scheme, including in particular the exemptive and rulemaking authority of Sections 6(c), 22 and 38(a). As the SEC itself has recently noted, no other security is as heavily regulated as are mutual fund shares.

The SEC's jurisdiction is being actively exercised. Indeed, measured progress in the direction which appellant seeks will soon occur as the SEC's 1974 Mutual Fund Report is implemented. This task, however, must be left in the exclusive domain of the SEC. It is the agency with the expertise and the day-to-day control over the mutual fund industry sufficient to appreciate the manner in which competition must be regulated to maintain the industry's continuous, primary distribution of securities. There is no room for antitrust decrees which might flatly proscribe that which the SEC wishes to condone, or prescribe that which the SEC wishes to prohibit. This is the essence of exclusive jurisdiction. The SEC must have the one hand on the tiller.

ARGUMENT

I. SECTION 22(f) AUTHORIZES RESTRICTIONS ON TRANSFERABILITY OF MUTUAL FUND SHARES WHICH ARE DISCLOSED TO THE SEC AND NOT IN CONTRAVENTION OF SEC RULES AND REGULATIONS, EVEN THOUGH THESE RESTRICTIONS MAY INHIBIT A SECONDARY MARKET FOR SUCH SHARES.

The complaint (Counts II-VIII) alleges that the distribution agreements of the three appellee funds contain transferability restrictions which inhibit or prevent dealers from participating in competitively priced secondary "brokerage" and "inter-dealer" markets. In this portion of the Argument, we will show that Section 22(f) of the Investment Company Act, read both literally and in accordance with its history, authorizes the very restrictions upon transferability attacked by the complaint and thereby immunizes those restrictions from antitrust challenge.

Section 22(f) says:

> *No registered open-end company shall restrict the transferability* or negotiability of any security of which it is the issuer *except in conformity with* the statements with respect thereto contained in *its registration statement nor in contravention of such rules and regulations as the Commission may prescribe* in the interests of the holders of all of the outstanding securities of such investment company. [Emphasis added.]

The District Court said:

> Clearly, by § 22(f) Congress specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rulemaking authority of the SEC.

> Just as clearly *Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications.* [J. App. 354; emphasis added.]

The District Court, therefore, correctly held that Congress' express validation of contract restrictions—restrictions which the appellant describes as *per se* violations of the antitrust laws (J.B. 18)—necessarily frees those restrictions from antitrust challenge. J. App. 354.

While accusing the District Court of "misinterpret[ing] both the language and legislative history of Section 22(f)" (J.B. 43), the appellant is itself remarkably reluctant to focus on the actual words and syntax of that Section, as enacted, or to consult the most authoritative historical background on Section 22(f)—the SEC's Investment Trust Study of 1940.

A. Section 22(f) Was Drafted Against a Background, Described in the Investment Trust Study, of Contractual Restrictions Aimed at Combatting the Secondary "Bootleg" Market.

The Investment Trust Study described a secondary "bootleg" market which was quite active during the 1920's and 1930's, competing in price against the fund-authorized primary market and engendering discrimination among investors. The Study detailed how funds, through restrictive agreements and otherwise, were combatting that market. The Study revealed that, for ten representative mutual funds during a four-week period in 1936, fully one-third of the share and dollar volume of purchases and sales of fund shares resulted from dealings by firms who were outside the funds' authorized contract distribution sys-

tem.[52] Indeed, for all fund shares over a several year period, the dollar volume of secondary market sales probably exceeded primary market sales.[53]

Like contract dealers, the non-contract dealers, or "trading firms" as they were called, "acted as principals rather than as brokers, in practically all transactions." [54] "[T]he 'trading firms' tended to trade at prices between the official bid and asked quotations established by the principal distributors, thus making an unofficial market." [55] According to the SEC Study, "It is this market made by the 'trading firms' which is sometimes characterized as the 'bootleg' or 'price-cutting' market." [56]

In a part of the Investment Trust study concerned with "abuses and deficiencies in the organization and operation" of investment companies, the SEC described the disruptive effects of the "bootleg market":

> The so-called "bootleg market" was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors of those companies. These dealers would often offer a little

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[52] Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 326-27.

[53] For the period 1927 through 1936, the SEC estimated the total dollar volume of sales by mutual funds through the primary distribution process as $564 million, of secondary market sales by principal underwriters as $50 million, and of secondary market sales by dealers and trading firms as $564 million. Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 809.

[54] *Id.*, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 327.

[55] *Id.*; see Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 856-57.

[56] *Id.*, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 328 n.85.

> more than the published redemption price and ask a little less than the published sale price. In an active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price. Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company.[57]

As the quoted passage indicates, these "unauthorized dealers" or "bootleggers" managed to survive, in part, because the legitimate underwriters and contract dealers would sell shares to them. Indeed, as the Study revealed, some principal underwriters and contract dealers were themselves operating secondary markets, involving transactions with unauthorized dealers and directly with investors, while engaging simultaneously in primary distribution activities. Contract dealers were filling customer purchase orders by using their own inventories (comprised of shares purchased from the fund purportedly for the dealers' investment or purchased from investors and trading firms), by going short (i.e., borrowing shares for delivery), and by matching customers' buy and sell orders.[58] Thus, the contract dealer who also operated his own secondary market in a fund's shares was able

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[57] Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 865 (footnotes omitted).

[58] *Id.* at 857-60.

to deprive the underwriter of its portion of the sales load and to undercut the primary distribution efforts of other contract dealers in that fund's shares.[59] Principal underwriters, too, used inventorying and secondary market activities to make extra trading profits at the expense of the funds or investors.[60]

As the Investment Trust Study reported, several funds adopted restrictive language in their underwriter and dealer sales agreements to combat the burgeoning secondary markets in fund shares. One fund prohibited its underwriter and dealers from buying for their own accounts and required that all orders be bona fide customer orders.[61] Another fund prevented its underwriter from accumulating an inventory for the underwriter's own trading account.[62] Another accomplished the same objective by amending its registration statement to forbid the underwriter from accumulating an inventory and from matching sell and buy orders.[63] In a fourth instance, "The selling contracts did not permit dealers to make resales of shares to persons other than bona fide investors without the consent of the * * * [funds] nor at any prices other than the established sales premiums [i.e.,

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[59] The price-cutting was on the average about 2% on the retail level. Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, at 810; SEC, Staff Report on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, Pt. II at 292 (1972), ("1972 Section 22(d) Report, Pt. II").

[60] Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, at 863-65.

[61] Id. at 828, 869.

[62] *Id.* at 868.

[63] *Id.* at 867-68.

loads].''[64] The Study recognized that such price-fixing eliminated any profit incentive for "the matching of purchases and sales by dealers * * *.''[65]

B. The Language and Drafting History of Section 22(f) Confirm That It Was Intended to Validate Private Efforts to Restrain the Secondary "Bootleg" Market.

When it submitted its Investment Trust Study to Congress in 1940 the SEC sent along its draft of a proposed Investment Company Act. Section 22(d)(2) thereof, the forerunner of Section 22(f), said that the Commission was "authorized * * * to prohibit * * * restrictions upon the transferability or negotiability'' of fund shares.[66] Mr. Schenker, chief counsel for the Investment Trust Fund, testified that the provision was designed to give the SEC regulatory authority over restrictions used by funds to combat the "bootleg market'' described in that Study.

> MR. SCHENKER.
>
> * * *
>
> Now coming to subparagraph (2) of (d), it just says that the Commission shall have the right to make rules and regulations with respect to any restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.

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[64] Id. at 871 (footnote omitted).

[65] *Id.* at 871 n.372. One fund also restricted secondary market trading by declaring in its prospectus that shares were "nontransferable'' to any person unless the fund consented to the transfer or failed to redeem the shares pursuant to the terms in the prospectus. *Id.* at 865 n.342.

[66] S.3580, 76th Cong., 3d Sess. § 22(d)(2) (1940). All of Section 22 of this SEC draft bill is printed in the Addendum to this brief, Add. 16-17.

There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. *It presents a whole problem which they call the bootleg market.* What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company. That is a big problem; but it seems to me they are taking away a very valuable indicium of the ability of the company, and it seems to me you are taking away a big portion of the owner's right of initiative.

If the committee wants the provision, we shall recommend what, on the basis of our experience up to the present time, it ought to be; but we think subjects like that ought to be a matter of rules and regulations.

SENATOR WAGNER. You provide rules?

MR. SCHENKER. That is right.

SENATOR WAGNER. You provide rules, I suppose, under which they make application to the Commission with respect to whether they may or not?

MR. SCHENKER. No. If this bill becomes law, and after we study the whole situation, if we feel there are abuses which cannot be corrected except by putting in a restriction on alienability, then we shall formulate rules, after discussing them with the industry.[67]

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[67] Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking & Currency, 76th Cong., 3d Sess. at 292-93 (1940) ("1940 Senate Hearings").

As evidenced by Senator Wagner's closing question to Mr. Schenker, Section 22(d)(2) of the SEC's draft bill did not make clear whether existing restrictions upon transferability and negotiability would remain lawful pending SEC rules or regulations to the contrary. However, this ambiguity was resolved in the revised bill, which emerged from industry-SEC negotiating sessions,[68] by a change of language that clearly affirmed the continuing validity of such restrictions. Section 22(f) of the revised and enacted bill says that no fund "shall restrict the transferability or negotiability [of its shares] * * * except in conformity with * * * its registration statement nor in contravention of such rules and regulations as the Commission may prescribe * * *."

The earlier SEC provision was merely enabling legislation; it permitted the SEC to regulate on the subject, but nothing more. The enacted language goes much further. By saying "may prescribe" rather than "shall prescribe," Congress recognized that the SEC might find it inadvisable to immediately issue any prohibitory rules or regulations on such transfer restrictions.[69] The plain meaning of Section 22(f) is

[68] The fact that the industry's initial counterproposal failed to grant the SEC even a veto power over transferability restrictions (J.B. 46) is all the more reason for inferring that each side compromised somewhat in the private negotiations which followed. The subsequent SEC-industry compromise bill gave the SEC veto power, but sanctioned the industry's transferability restrictions *unless and until* that veto might be exercised.

[69] The Senate Committee report on the bill evidenced the same understanding: "The negotiability of open-end securities *may* not be restricted in contravention of provisions which *may* be formulated (Sec. 22)." S. Rep. No. 1775, 76th Cong., 3d Sess. 16 (1940) (emphasis added). The House Committee report is to the same

that the transfer restrictions *remain valid,* in the absence of SEC regulatory action, *provided* that they continue to be *fully disclosed in the registration statements* filed at the SEC. Section 22(f)'s phrase "except in conformity with" reinforces this plain meaning that restrictions, such as those described in the Investment Trust Study, are sanctioned *unless* and *until* the SEC exercises its exclusive jurisdiction to prohibit or modify them.

C. Section 22(f) Plainly Validates Restrictions Imposed By Underwriter-Dealer Agreements, Irrespective of State Law.

Without regard to the purposes and history of Section 22(f), the appellant contends (J.B. 42-8) that the provision applies only to that supposedly limited class of transferability restrictions which funds themselves are permitted by state law to print upon the face of share certificates. The appellant's argument is founded upon the wholly unsupported premise that Section 22(f) must be read in this narrow fashion in order to avoid any unintended preemption of state laws and, by analogy, any exemption from the federal antitrust laws.

1. It would be strange indeed if Congress meant Section 22(f) to apply only to "restraints in the alienability or negotiability of the *fund shares themselves*", as distinct from "restraints of the distribution mechanism * * *." J.B. 43 (emphasis added). Pre-1940 efforts to deal with the bootleg market were not, by

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effect: "Subsection (f) provides that the negotiability or transferability of redeemable securities of open-end companies *may* not be restricted in contravention of rules and regulations which the Commission *may* prescribe." H.R. Rep. No. 2639, 76th Cong., 3d Sess. 20 (1940) (emphasis added).

any means, confined to the use of restrictions printed upon the face of fund share certificates, as the Investment Trust Study clearly shows. According to the Study, ***distribution contracts*** were frequently used to restrict "transferability."[70] Congress clearly expected that use to continue, wanted the fact of such use disclosed to the SEC in registration statements, and empowered the SEC to issue rules and regulations regarding all transferability restrictions, including those imposed by distribution contracts.[71] Had Congress meant to limit the Section to those restrictions which appear on the face of share certificates, it would have said so. Instead Congress provided simply that a Section 22(f) restriction, to be valid, must appear in the mutual fund's "registration statement." The word "certificate" is never mentioned.[72]

The SEC itself has never doubted that Section 22(f) extends beyond certificate-imposed restrictions. As far back as 1941, in conjunction with its description of NASD Rule 26(j)(2) as "a restriction upon the transferability of securities," the SEC noted that Section 22(f) also empowers the Commission to regulate "restrictions upon the transferability or negotia-

[70] See pages 29-30, *supra*.

[71] Although SEC counsel Schenker, in his 1940 Senate testimony, see page 31, *supra*, mentioned what may have been a certificate-disclosed transferability restriction, Schenker never intimated that then-Section 22(d)(2) would be confined to that limited type of restriction.

[72] Some mutual fund shares are not even represented by share certificates. See Inv. Co. Act Rel. No. 6366 (1971), F. Sec. L Rep. ¶ 77,966 (uncertificated shares); *e.g.*, GX 8, J. App. 254) (fractional shares). Those who are purchasing under contractual plans do not receive share certificates initially. See pages 5-6, footnote 9, *supra*.

bility of securities."[73] In its 1974 Mutual Fund Report, the SEC declared its intention to exercise that Section 22(f) authority against transferability restrictions imposed by *contract,* not by share certificates.[74] Plainly, therefore, the SEC does not believe its Section 22(f) power is confined to restrictions inhering in fund certificates.

2. The appellant seems to assert, albeit obscurely, that some of the alleged transfer restrictions are underwriter-imposed (*i.e.,* set forth in the underwriter-dealer sales agreements) rather than "fund-imposed" (J.B. 43) and, therefore, are outside the reach of Section 22(f). This argument ignores the following: (1) the Investment Company Act requires each mutual fund to enter into a distribution agreement with a principal underwriter,[75] (2) SEC-approved NASD Rule 26(c) requires the principal underwriter agreement to enter into a written selling group agreement with dealers, (3) the fund-underwriter agreement invariably provides that the underwriter will comply with NASD rules including the one requiring a selling group agreement, and, most importantly, (4) the fund must include both the fund-underwriter and the underwriter-dealer agreements in its registration statements filed at the SEC.

The appellee funds in this case have always been totally aware of any restrictive language in their selling group agreements, and have dutifully included those agreements in their registration statements and

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[73] *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.,* 9 S.E.C. 38, 44-5 and n.10 (1941).

[74] 1974 Mutual Fund Report at 105, 105 n.1, 106.

[75] Section 15(b) of the 1940 Act, 15 U.S.C. § 80a-15(b).

other periodic filings at the SEC.[76] The funds have, in effect, authorized, approved, and ratified the agreements.[77] Indeed, given the close, continuing relationship between mutual funds and their principal underwriters (as contrasted with the usual arms' length relationship between conventional securities issuers and their underwriters), it would be odd indeed if Congress meant Section 22(f) to give the SEC regulatory authority over restrictions directly imposed by a fund on its affiliated underwriter, but not over dealer restrictions imposed on behalf of that fund by its underwriter.

The SEC has never construed Section 22(f) so narrowly. The 1974 Mutual Fund Report contemplates the possibility of SEC action against contract restrictions which are embodied in underwriter-dealer agreements.[78] Clearly, then, Section 22(f)'s sanctioning of properly disclosed transferability restrictions, subject to SEC regulation, applies to restrictions imposed by underwriter-dealer agreements as well as to restrictions imposed by fund-underwriter agreements.

3. The appellant raises a complete red herring: "Appellees have not contended that Section 22(f) preempts state law requirements, and there is no basis for such a claim." (J.B. 48.) There was no occasion in the court below for appellees to make such a contention. This case, after all, does *not* involve attempted enforcement of a *state* law in the face of a conflicting *federal* law. The case is an effort to enforce the *fed-*

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[76] J. App. 155-56.

[77] The appellant itself alleges that one fund-underwriter agreement expressly requires that the underwriter's dealer agreement contain the restrictions now challenged in this suit. Complaint ¶ 29, J.App. 12.

[78] 1974 Mutual Fund Report at 105 n.1.

eral antitrust laws in the face of more recent, conflicting *federal securities* laws.

State laws are typically concerned with *disclosure* of restrictions *to the persons directly bound thereby.* Disclosure is not a problem here where the alleged transfer restrictions are embodied in contracts actually signed by the dealers. Apart from constructive notice through the public filing of these contracts at the SEC, the dealers, as parties to the contracts, have *actual notice* of restrictions upon their right to transfer fund shares.[70] The Uniform Commercial Code provision cited by the appellant (J.B. 47 n.40) does not *proscribe* transfer restrictions. If someone receives no notice, the restriction simply cannot be enforced as to him. Thus, there is no conflict between a state law *proscription* and a federal law (*i.e.,* Section 22(f)) *validation.*

In any event, the questions of state law preemption and federal antitrust immunity are not the same. The state laws described by the appellant can probably operate without conflicting with the SEC's regulatory jurisdiction. It is quite another thing, however, to suggest that the federal antitrust laws are not in conflict with SEC regulation under Section 22(f). The appellant as much as admits this by its contention that the restrictions at issue here are *per se* violations of the antitrust laws (J.B. 17-18). On its face, there is no way to reconcile the SEC's jurisdiction under Section 22(f) to approve, disapprove,

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[70] Article 8, Section 204 of the Uniform Commercial Code, which provides that a restriction on transfer is "ineffective" unless conspicuously noted on the security, makes an express exception for "a person with actual knowledge of the restriction." See UCC Rep. Serv. ¶ 8204.

or otherwise regulate transfer restrictions with the appellant's contention that the same restrictions are irrebutably, *i.e., per se,* illegal under the federal antitrust laws. It is illusory to suggest in these circumstances that the SEC would still retain jurisdiction to impose "further limitations" on transfer restrictions (J.B. 44), for if the restrictions are *per se* illegal under the antitrust laws, there would be nothing left to which the SEC could properly add "further limitations."

D. The SEC Has Not Limited the Transferability Restrictions in Appellees' Agreements and Has Permitted Their Validation Under Section 22(f), Despite Full Knowledge of Their Restrictive Effects.

The record demonstrates that the appellees' distribution agreements, including any restrictions on brokerage and inter-dealer secondary market transactions, have met the validation requirements of Section 22(f) and, accordingly, are exempt from antitrust attack. As found by the court below (J. App. 354), it is undisputed that each appellee fund has filed its allegedly offending agreements, and all amendments thereto, with the SEC, in accordance with SEC-prescribed registration statement forms. There is no claim that the appellees have acted in any way "except in conformity with" those registered agreements. Thus, the appellees cannot be denied the protection of Section 22(f) because of any incomplete or improper disclosure of their agreements before the SEC.

As the District Court found, "[T]he SEC has never challenged the validity of uniform sales agreements." J. App. 354. In 1963, the SEC acknowledged in a report to Congress that restrictive clauses in these registered sales agreements complemented the provi-

sions of the Investment Company Act in preventing the development of a competitive secondary market:

> [T]he sales organizations are protected by "fair trading" or resale price maintenance in their sale of mutual fund shares under the Investment Company Act, the rules of the NASD, and *private sales agreements.*
>
> * * *
>
> In theory, without these fair trade arrangements, a trading market for mutual fund shares could exist, with purchasers buying at prices below the prices stated in the prospectus (net asset value plus, say, 8.5 percent) and sellers selling at prices above the contractual redemption price (net asset value). Prior to the passage of the Investment Company Act, indeed, there was such a market. The fair trade arrangements established by the act, the NASD rules *and the private sale agreements* now make it extremely difficult for a trading market in mutual fund shares to exist and to provide competition for the large mutual fund selling organizations in the sale of fund shares.[80]

The 1972 Section 22(d) Report, quoted by the District Court, (J. App. 354), recognized that "[o]ften the [selling group] contract requires him [the dealer] to place all orders with the principal underwriter and to refrain from any attempt to obtain shares from other sources."[81] Yet this sort of restriction, which the SEC for thirty-five years has knowingly declined to prohibit because of its contribution to the viability of the primary distribution-redemption system, is one

[80] 1963 Special Study at 98. As explained at page 52, *infra*, Section 22(d) does much more than the typical "fair trade" statute.

[81] 1972 Section 22(d) Report, Pt. I, 24, in F. Sec. L. Rep. Report No. 450, Pt. II at A-109.

of the principal restrictions under antitrust attack in this case.[82]

In adjudicated matters, the SEC has also focused upon the meaning and legality of the transfer restrictions in the funds' distribution contracts. For instance, in a 1971 action, the Commission quoted and discussed the restrictive language of two typical dealer agreements:

> In one [of the selling group agreement forms in the record] the underwriter states: "You agree to purchase shares through us at the offering price then in effect as agent for your customers or for resale to your customers as principal." In the other it states: "You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors. . . ."[83]

In a 1972 opinion, SEC Commissioner Loomis, a former SEC General Counsel, stated unequivocally:

> I would conclude that applicant is a dealer in its relationship with the fund underwriter because to do otherwise would require us to ignore or *nullify the perfectly lawful requirement in the dealer agreements that applicant act as a dealer. * * * [I] do not know of anything unlawful about the generally accepted form of dealer agreement used in the investment company industry.*[84]

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[82] See Complaint ¶¶ 23(b), 35(b), 47(b), and 58(c), J.App. 10-11, 13, 15, and 17.

[83] *First Multifund of America, Inc.*, Inv. Co. Act Rel. No. 6700 (1971) F. Sec. L. Rep. ¶ 78,209 at p. 80,602 n.7. The language quoted from the second agreement is, in fact, identical to the language used by The Crosby Corporation, one of the appellee underwriters in this appeal. See J. App. 36.

[84] *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 at 7 (1972) (dissent) (emphasis added). The majority expressed

In its 1974 Mutual Fund Report, the SEC recognizes once again its exclusive jurisdiction under Section 22(f) over restrictions upon the transferability of mutual fund shares.[85] The SEC evidences for the first time, however, a desire to change some aspects of those contractual provisions which it has long permitted to exist.[86] In order to learn whether fund investors can be made price-conscious, the SEC proposes a heavily safeguarded experiment in price-sensitivity. The SEC would permit contract dealers to engage in "genuine matching" in a carefully circumscribed secondary brokerage market.[87] The Commission intends to accomplish this experimental objective through NASD rules and the exercise of its Section 22(f) authority. Conversely, while the 1974 Report evidences full knowledge of the allegations in this case,[88] the Commission proposes no comparable changes under Section 22(f) regarding contract restrictions which allegedly inhibit or prevent secondary inter-dealer transactions.[89]

This recent active assertion of SEC jurisdiction is all the more reason for antitrust enforcement to respect the exclusive jurisdiction which Congress has accorded to the SEC. The lower court was correct, and indeed foresighted, in its conclusion that these

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disagreement with Commissioner Loomis on the facts of the case, but not on the legality of the selling group agreements.

[85] 1974 Mutual Fund Report at 105, 105 n.1, 106, 109. The Report is more fully discussed at pages 102-04, *infra*.

[86] *Id.*

[87] *Id.* 105-07.

[88] *Id.* at 104.

[89] Id. at 104-08. See page 104, *infra*.

antitrust challenges to mutual fund distribution agreements should be dismissed because of the irreconcilable conflict which they would cause to the SEC's authority under Section 22(f).[90]

II. SECTION 22(d) PROHIBITS CONTRACT DEALERS IN A MUTUAL FUND'S SHARES FROM PARTICIPATING IN SECONDARY BROKERAGE MARKET TRANSACTIONS IN THOSE SHARES AND, ACCORDINGLY, EXEMPTS FROM ANTITRUST CHALLENGE ANY ALLEGED AGREEMENTS NOT TO SO PARTICIPATE.

In this Argument section we will show (A) that the language and (B) that the Congressional history and the administratively and legislatively described purposes of Section 22(d), forbid a contract dealer in a mutual fund's shares from selling those shares as an investor's agent in the "brokerage market" hypothesized by appellant. As the District Court found, "brokerage transactions, necessarily executed in the secondary market, [are] within the prohibition of § 22(d)." J. App. 350. Thus, as that court held, any agreement which allegedly prohibits or inhibits such "brokerage transactions" is consistent with the statutory objective and does not violate the antitrust laws.

A. The Plain, Defined Terms of Section 22(d) Do Not Permit a Brokerage Transaction Exception from the Statutory Price Maintenance Obligation.

1. *Mandatory Price Fixing by Prospectus*

In relevant part, Section 22(d) says:

> No registered investment company shall sell any redeemable security issued by it to any per-

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[90] See page 109 *et seq.*, *infra*.

> son except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no pricipal underwriter of such security and *no dealer shall sell any such security to any person* except a dealer, a principal underwriter, or the issuer, *except at a current public offering price described in the prospectus.* * * * * [Emphasis added.]

The "prospectus" to which Section 22(d) refers is the investment company's current written prospectus filed at the SEC to meet the requirements of Section 10(a) of the Securities Act of 1933, 15 U.S.C. § 77j(a).[91] The "current public offering price," as used in Section 22(d), is the proportionate "net asset value" of the fund's portfolio investments plus a "sales load" to compensate the underwriter and dealer for their promotional and selling effort. Actually, the prospectus does not describe the "current public offering price" in precise dollars and cents. That is because the underlying asset value fluctuates daily and is calculated for a given day's fund share transactions on the basis of quotations for the fund's portfolio assets at the close of the stock exchanges that day. See 17 C.F.R. § 270.22c-1. The prospectus, however, does establish a fixed sales load percentage to be added to the daily asset value in order to form the selling price. In that sense, there is "a current public offering price described in the prospectus."

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[91] See Section 2(a)(31) of the 1940 Act, 15 U.S.C. § 80a-2(a)(31).

2. *Express Exemption for Fund-Underwriter-Dealer Sales Only*

Under Section 22(d), neither the fund, nor its principal underwriter, nor a dealer, may sell fund shares "to any person" except at the same price as the "current public offering price" described in the prospectus for the particular purchase volume involved.[92] The three necessary exceptions to Section 22(d)'s otherwise flat ban on cut-price sales "to any person" are made *expressly*. The only such exception relevant to this case[93] is that discount sales may be made to "a dealer, a principal underwriter, or the issuer," but not to anyone else. This limited exception is perfectly understandable. Without it, mutual funds would have had to abandon their traditional practice of compensating their distributors by selling to them at discounts from the public price. That Section 22(d)'s draftsmen felt compelled to make these exceptions explicit, indicates that they neither intended nor expected that other exceptions would be implied. Consequently, the failure to insert into Section 22(d) an express exception allowing a dealer to sell to one investor from another in a cut-price brokerage transaction signifies that such an exception was never intended or desired.

3. *Definition of "Dealer"*

For purposes of this case, the key terms in Section 22(d)'s command that "no *dealer* shall *sell* any such

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[92] When the fund offers quantity discounts for larger volume purchases, the prospectus fixes an applicable sales load for each volume level and, thereby, describes "a current public offering price" for each level.

[93] Exceptions for reorganizations and for certain offers made solely to existing shareholders are *expressly* stated in Section 22 (d)'s second sentence.

security to any person * * * except at a current public offering price described in the prospectus" are the underlined words "dealer" and "sell." Both are carefully defined in the Act.

Section 2(a)(11) says that "dealer"

> means *any person regularly engaged in the business of buying and selling securities for his own account,* through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business. [Emphasis added.]

The first thing to note is that "dealer" is defined as "any person." The statute's price maintenance command to "dealers" is directed at the "person" and not at the particular transactional capacity in which the "person" might choose to act.[94]

The second important aspect of the "dealer" definition is its requirement that the "person" be "*regularly* engaged in" an on-going "business."[95] The

[94] The SEC's pre-Act Investment Trust Study used the term "dealer" to mean dealer *qua* person, not a particular transactional capacity, *viz.*: "dealer * * * acted as agent," "dealer (for customer's account)," "where the dealer acted as principal," "if the dealer were acting as agent," "where both dealer and distributor acted as agents," "where a dealer acted as principal," "dealers acted as agent or as principal," and "the dealer acting as principal." Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 857, 858, 859, and 861. This was the authoritative study upon which the 1940 Act was based.

[95] Evidently, the draftsmen's choice of the word "regularly" was deliberate. In the SEC's 1940 draft of an investment company bill—a draft which did not include any provision resembling Sec-

definition does not focus on the person's "capacity" in a particular transaction at a particular point in time. It does not say that a person is a dealer "when, and only when" he makes a particular purchase or a particular sale for his own account. The definition simply requires that there be a level of *regularity* in the person's practice of engaging in the "business of buying and selling securities for his own account." Once that level is achieved, as in the case of regular contract dealers, then the "person" must comply with all the statutory commands directed at "dealers." In the case *sub judice,* it is undisputed that each of the appellee dealers is a "person regularly engaged in the business of buying and selling securities for his own account," including the shares of the appellee mutual funds.

A third important facet of the "dealer" definition is that where Congress intended an exception to that definition, it inserted that exception *expressly.* Section 2(a)(11) has four express exclusions: banks, insurance companies, investment companies, and persons who buy and sell securities for their own accounts "but not as part of a regular business." Plainly, there are no other express exceptions for persons who otherwise meet the occupational definition of "dealer." Congress would have added a fifth exception if it had intended that persons who meet the "dealer"

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tion 22(d)—"dealer" was defined by referential incorporation of the "dealer" definition in Section 3(a)(5) of the 1934 Act, 15 U.S.C. § 78c(a)(5). See Section 45(a)(4) of S.3580, 76th Cong., 3d Sess. (1940). That definition said simply "any person engaged in the business," not "any person *regularly* engaged in the business." When Section 22(d) was added to the bill, a special definition of "dealer," with the inserted word "regularly," was also added.

definition might shed their statutory "dealer" price maintenance obligation in a given "brokerage" or "agency" transaction. Indeed, whenever Congress wanted the fact of a person's obligations under the Investment Company Act to turn on his particular transactional capacity, Congress invariably inserted *explicit* capacity-oriented language into either the applicable definition section[96] or the substantive provision itself.[97] A "brokerage" capacity exception was *not* inserted into the "dealer" definition or into Section 22(d).[98]

[96] Section 2(a)(8), 15 U.S.C. § 80a-2(a)(8), defines "company" to include a company receiver, bankruptcy trustee, or liquidation agent *"in his capacity as such."* Section 2(a)(17), 15 U.S.C. § 80a-2(a)(17), defines "insurance company" to include the company's receiver or liquidating agent *"in his capacity as such."* "Principal underwriter" is defined in such a way as to make references to the fact that the "principal underwriter" may be acting *"as principal"* or *"as agent"* and to make it clear that a dealer does not have the obligations of a principal underwriter when the principal underwriter is "acting as agent" for the fund. Section 2(a)(29), 15 U.S.C. § 80a-2(a)(29).

[97] Section 17(a), 15 U.S.C. § 80a-17(a) prohibits certain transactions between the investment company and a person affiliated with the company's principal underwriter if that person is *"acting as principal."* Section 17(d), 15 U.S.C. § 80a-17(d), bars such person from *"acting as principal* to effect any transaction" in which the investment company is a joint venturer with that person. Section 17(e)(1), 15 U.S.C. § 80a-17(e)(1), prevents the affiliated person *"acting as agent"* from accepting compensation (other than salary or wages) for the sale of property to, or for, the investment company "except in the course of such person's business as an underwriter or broker."

[98] If the appellant's transactional capacity analysis were available to unethical "dealers" in the industry, there might be attempted evasions of other provisions of Section 22. For instance, Section 22(c) of the 1940 Act, 15 U.S.C. § 80a-22(c), grants the SEC regulatory authority over "dealers" and others to prevent, *inter alia,* sales, repurchases, and redemptions effected by them in ways

It is the appellant, therefore, not the appellees, which seeks to "unjustifiedly expand" Section 22(d) and "read * * * into" it (J.B. 22) a brokerage capacity exception not expressly stated therein.[99] Appellees, on the other hand, would adhere to the definition of "dealer" that the statute itself supplies.[100]

4. *Definition of "Sell"*

The statute's broad definition of "dealer" takes on even more significance because the word is used by Section 22(d) in conjunction with the equally broad word "sell": "[N]o *dealer* shall *sell* any such security

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which are "unfair to holders" of fund shares. (See reference to Section 22(a) therein.) As with Section 22(d), it defeats the statute's objective if a person who meets the occupational definition of "dealer" can, by purporting to "broker" shares, evade Section 22(c) regulations designed to protect investors from unfair results. For example, we doubt that the SEC subscribes to the view that a "dealer" may simply "broker" a repurchase from an investor at less than net asset value and avoid the clear prohibition in 17 C.F.R. § 270.22c-1 against such an unfair transaction. But see J.B. at 29-30 n.25.

[99] The appellant is not even consistent in its assertion (J.B. 22) that "brokerage transactions" are outside Section 22(d). The appellant concedes that when a dealer purports to act as an investor's "agent" in a distribution from fund to investor, the dealer's "brokerage transaction" is covered by Section 22(d)'s fixed-price mandate. J.B. 23 n.18.

[100] The fact that "broker" has its own definition in the 1940 Act, Section 2(a)(6), 15 U.S.C. § 80a-2(a)(6), instead of being subsumed under the definition of "dealer" as in the Securities Act of 1933, 15 U.S.C. § 77b(12), does not detract from the plain meaning of Section 22(d) and its defined terms "dealer" and "sell." A definition of "broker" was needed to clarify the meaning of several provisions of the Act unrelated to distribution and price maintenance of mutual fund shares. *E.g.*, Sections 2(a)(19), 10(b), 17(e)(2) and 31(a), 15 U.S.C. §§ 80a-2(a)(19), -10(b), -17(e)(2), -30(a).

* * * except at a current public offering price described in the prospectus." Section 2(a)(34) of the Act treats "sell" as a synonym for "sale," "offer to sell," and "offer for sale." The terms are jointly defined to include "every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." The Act supplies no separate definition for "selling as agent," as distinguished from "selling as principal." The single statutory definition applies in all cases regardless of how the seller might characterize his capacity in a particular transaction or attempted transaction.

Congress, therefore, has made it clear that, wherever the word "sell" is used in the Investment Company Act, it includes not only those activities which occur during the actual agreement, confirmation, and performance of a sale, but also *any and all of a person's efforts to obtain or effect a sale, whether successful or not.* In the context of Section 22(d), this means that a "dealer" may not solicit a sale to the public at less than the public offering price, either by an "offer to sell" or an "offer for sale" or a "solicitation of an offer to buy." The "dealer" may not offer to dispose of fund shares in such a sale, attempt to dispose of fund shares in such a sale, actually dispose of shares in such a sale, or enter into a contract for such a sale and disposition.[101] Section 48(a) of

[101] Under the federal securities laws, defined terms such as "sell" are to be given an expansive construction so as to ensure effectuation of the laws' purposes. *Mader* v. *Armel,* 402 F.2d 158, 160 (6th Cir.), cert. denied, 394 U.S. 930 (1968); *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 634 (2d Cir.), cert. denied, 389 U.S. 970 (1967); *United States* v. *Monjar,* 47 F.Supp. 421 (D. Del. 1942), aff'd, 147 F.2d 916 (3rd Cir.), cert. denied, 325 U.S. 859 (1944). Indeed, such

the Act, 15 U.S.C. § 80a-47(a), extends the selling prohibition to such activities when done "indirectly" by the dealer, or "through * * * any other person," or "by means of any other person."

Given these statutory definitions of "dealer" and "sell," as supplemented by Section 48(a), it should be readily apparent that Section 22(d) prevents the appellee contract "dealers" from participating in *any real effort,* whether as principal or as agent, to effect a sale to an investor in a brokerage market "match" at less than the applicable public offering price. For instance, if a retiring investor were to ask a dealer to sell shares in the hypothesized brokerage market provided that a price advantage was available there, the dealer legally could not *solicit* a matching offer to buy. Nor could he wait very long for the fortuitous arrival of an *unsolicited* buyer of an identical lot of the same fund's shares, given the risk that the selling investor might miss that day's redemption price and might be forced to accept a lower price thereafter.[102] Conversely, if a new investor were to ask a dealer to purchase shares in the brokerage market, the dealer legally could not *solicit* a matching offer to sell. In fact, since fund shares are long-term investments and since present holders have already purchased redemption rights as part of their initial sales load

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construction is especially appropriate here where, unlike in the other securities laws, even *solicitation* is defined as a "sale." Compare the 1940 Act definition with Section 2(3) of the 1933 Act, as amended, 15 U.S.C. § 77b(3), and Section 3(a)(14) of the 1934 Act, 15 U.S.C. § 78c(14).

[102] Rule 26(f)(1) of the NASD's SEC-approved Rules of Fair Practice prohibits member dealers from withholding orders. In any event, no dealer would want to risk responsibility for missing the redemption price on the day of the order.

payments, soliciting them to sell their shares is generally considered improper.

5. *Criminal Penalties for Price Cutting*

Congress and the SEC have repeatedly cautioned [103] that a dealer who violates Section 22(d) exposes himself to *criminal* punishment [104] as well as other severe sanctions.[105] Respect for the law would steer any reasonably prudent "dealer" far from any selling activity that conceivably could be construed to fall under Section 22(d)'s prohibitions. Certainly when Congress made mutual fund price cutting a crime, it evidenced a clear desire *not* to allow the plain language and defined terms of Section 22(d) to be circumvented by loopholes of any sort, including a "dealer's" participation in cut-price, brokerage sales to investors.[106]

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[103] See pages 75-76, *infra*.

[104] Section 49 of the 1940 Act, 15 U.S.C. § 80a-48, provides a $10,000 fine and two years' imprisonment for a willful violation of "any provision" of the Act. Anyone who aids or abets a violation is subject to criminal liability under 18 U.S.C. §2.

[105] The SEC may revoke a dealer's registration or apply lesser sanctions. See, *e.g.*, *In re Bakos*, Inv. Co. Act Rel. No. 7469 (1972), F. Sec. L. Rep. ¶ 79,095. The NASD may expel the offending dealer or impose lesser penalties. See, *e.g.*, *In re Sideris*, Exch. Act. Rel. No. 8816 (1970).

[106] The antitrust laws, of course, make price *fixing* a felony punishable by as much as three years' imprisonment and a $100,000 fine for individuals, and $1 million for corporations. Pub. L. No. 93-528, § 3 (Dec. 21, 1974), amending Section 1 of the Sherman Act, 15 U.S.C. § 1. While the Justice Department has not chosen the criminal route in this case, it would be most extraordinary if Congress intended mutual fund dealers to walk the tightrope which the appellant seeks to erect by means of this lawsuit. If the appellant's theories were to prevail here, a statutory "dealer" would be subject to criminal punishment under the *antitrust* laws if he agrees *not to sell* fund shares in cut-price *"broker"* transactions and he

6. *Sharp Contrast With "Fair Trade" Laws*

As the SEC and Congress have often acknowledged,[107] the price fixing system imposed by Section 22(d) is altogether different from state "fair trade" laws, whether of the "signer" or "non-signer" type. This is *not* a case like *United States* v. *McKesson & Robbins, Inc.*, 351 U.S. 305 (1956), where a federal statute simply *permits civil* enforcement under *state* law of *privately imposed* price maintenance requirements. Compare J.B. 14, 22, 24. Here, *Congress commands* strict price maintenance, regardless of state law or private enforcement initiatives, and it makes departures from price maintenance a *federal felony*. Rather than granting "a *privilege* restrictive of a free economy," *United States* v. *McKesson & Robbins, Inc., supra*, 351 U.S. at 316 (emphasis added), Section 22(d) *mandates* a *restricted* economy in order to preserve the unique continuous distribution system for redeemable mutual fund shares.

B. Participation by Fund Dealers In A Secondary Brokerage Market Would Contravene Section 22(d)'s Legislative History and Purposes.

We have just shown that Section 22(d), by its defined terms, prohibits funds, underwriters, and dealers from engaging in *any* sales to investors, including *any secondary market sales*, at less than the current public offering price. In adopting that interpretation, the court below correctly observed (J. App. 346-53) that such a reading of Section 22(d) is confirmed by the SEC's 1940 Investment Trust Study, the legislative history of Congressional actions in 1940

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would be subject to criminal punishment under the *securities* laws if he *does sell* fund shares in cut-price "*dealer*" transactions.

[107] See pages 69, 75, 76, *infra*.

and in 1967-1970, and the SEC's many pronouncements regarding Section 22(d)'s purposes. The appellant, on the other hand, bases its case on the wholly unsupported belief that "a secondary market * * * was not a matter of concern to Congress" (J.B. 20) and that Section 22(d) "was not intended to eliminate competitive secondary markets." (J.B. 24).

1. *Section 22(d)'s Genesis Reveals Its Anti-Secondary Market Character*

Section 22(d) is best understood by reference to the historical setting in which it arose. As the District Court found, "in the pre-1940 period there was in fact a secondary market in mutual fund shares, a market very similar in size and scope as that for which plaintiffs here attempt to make a case." J. App. 347. We have related (pages 26 to 30, *supra*), the extensive findings of the SEC's Investment Trust Study regarding pre-1940 secondary or "bootleg" market activity in fund shares. Brokers and dealers who were not under contract to fund underwriters were selling shares among themselves and to the public at less than the prospectus-disclosed prices at which contract dealers were obliged to sell identical shares. Contract dealers were tempted, and in many cases forced by competitive pressure, to participate in such cut-price sales. The contract distribution system was disrupted, contract dealers cancelled their contracts, and investors were subjected to disillusioning price-discrimination.[108] The SEC's report to Congress recounted the variety of measures, including restrictive contracts, by which mutual funds and their under-

[108] See 1972 Section 22(d) Report, Pt. I, F. Sec. L. Rep. Report No. 450, Pt. II at A-115.

writers were attempting to eliminate the "bootleg" market.

Like the final version of Section 22(f), whose genesis has been described (see pages 30 to 33, *supra*), Section 22(d) was a direct outgrowth of the funds' battle against secondary market activity. The draft bill submitted by the SEC to Congress in 1940 did not contain any provision even remotely resembling present Section 22(d). The bill ran into heavy industry opposition at the first round of Senate hearings, principally because it had been written without sufficient consultation with responsible industry spokesmen.[109] The draft bill gave the SEC extensive power to regulate the industry, but gave the industry nothing in return.

Section 22(d) derived in part from a counterproposal designed to break the Senate hearing deadlock. According to the SEC, the provisions of Section 22(d) "were first suggested by members of the industry." [110] Apparently this occurred near the end of the first round of Senate hearings, when an industry spokesman proposed, *inter alia,* that Section 22 "provide that no securities issued by an investment company shall be sold to insiders or to anyone except on the same terms as are offered to other investors." [111] These exact words were incorporated in a memorandum of agreement in principle between the industry and the SEC shortly after the hearings recessed.[112]

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[109] 1940 Senate Hearings at 406-07 (Mr. Bunker).

[110] *Midamerica Mutual Fund, Inc.,* 41 S.E.C. 328, 331 (1963).

[111] 1940 Senate Hearings at 1057.

[112] *Id.* at 1106; Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate & Foreign Commerce, 76th Cong., 3d Sess. at 99 (1940) ("1940 House Hearings").

The detailed give-and-take of SEC-industry negotiations during the several weeks before the Senate hearings resumed were largely secret. However, the concrete concessions gained there by the industry were plainly disclosed on the face of the resulting compromise bill. As noted *supra,* Section 22(f) was rewritten to specifically sanction fund-imposed restrictions on the secondary market activities of principal underwriters and contract dealers. Section 22(d) carried the logic of Section 22(f) one step further—into the secondary market activities of dealers who, lacking fund distribution contracts, could not be controlled by the funds under Section 22(f) and basic contract law. As the court below recognized, "The effect of the Act was for the first time to bind noncontract dealers to the public offering price." J. App. 348. When Section 22(d) said "no dealer," it meant no dealer, whether bound by contract or not, and whether engaged in primary or secondary market activity, or both.

Contemporary statements by opponents of Section 22(d), subsequent SEC pronouncements, and the whole tenor of Congressional hearings and debates in the late 1960's, confirm that Section 22(d) was aimed at suppressing secondary market activity because of its disruptive, price-competitive, and discriminatory character.

2. *Opponents of Section 22(d) Recognized in 1940 that it was Aimed at Their Secondary Market Activities*

Asiel & Co., an important factor in the active secondary or "bootleg" market of the 1930's,[113] cir-

[113] See Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70, at 326, n.80; see also 1972 Section 22(d) Report, Pt. II at 293.

culated a memorandum in August, 1940, entitled "Memorandum Covering S.4108," the Senate number for the pending industry-SEC compromise bill. J. App. 312. The memorandum said in relevant part:

> As we read Sec. 22(d) of the proposed bill, it will seriously curtail free "street" trading in the redeemable securities of open-end investment companies.
>
> * * *
>
> *If Section 22(d) goes into effect, it will be impossible for an individual investor or a broker to take advantage of the lower market made by the street* [*non-contract*] *dealer.*
>
> * * *
>
> It has been asserted that the operations of street dealers have resulted in certain abuses, and the enactment of Section 22(d) will eliminate these abuses. The claimed "abuses" are that the activities of the independent dealers:
>
> (a) Create unfair competition between "authorized" dealers (*i.e.* dealers in privity with the principal underwriters) and street dealers, to the prejudice of the former * * *.
>
> * * *
>
> *If the provision* [*22(d)*] *will achieve anything at all—and we think it was designed for this purpose—it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly.* [J. App. 313, 315; emphasis added.]

Another self-acknowledged "street" trader in mutual funds, Goodbody & Co., stated in August, 1940, in correspondence filed at the NASD:

> You are no doubt familiar with the text and history of the Wagner-Lea Bill to regulate investment companies which has just been passed

by both Houses of Congress. We believe that this bill, which was drawn up with the assistance of a small committee of representatives of the underwriting houses, as a whole is an excellent bill. Due to the fact however, that brokers and dealers had no representation, it has been possible to insert into this bill a paragraph which only protects the underwriting houses but is detrimentally harmful both to the investing public and to the street.

The joker is to be found in section 22 paragraph D, which paragraph we together with others have vigorously but unsuccessfully opposed in Washington. A memorandum prepared by us and our Associates and sent to every individual Senator explaining our objection is enclosed herewith.

We doubt that it has been generally realized that under this section it will be illegal for a broker to come into the independent street market and buy for a client any mutual trust shares, unless his client is charged the full published offering price established by the underwriter. [J. App. 321.]

Clearly, those most concerned with preserving a competitive secondary market saw the handwriting on the wall in 1940. They knew that Section 22(d) was meant to destroy the principal economic incentive for such a market—the price advantage available to secondary market investors. As the secondary market participants recognized, Section 22(d) was unquestionably "designed for this purpose" of curtailing secondary market activity.

3. *The SEC Has Long Acknowledged the Secondary Market Objectives of Section 22(d)*

The appellant asserts that "Section 22(d) was addressed to abuses in the primary distribution of mutual

fund shares, *not to secondary level transactions.*"[114] J.B. 19-20 (emphasis added). This should come as a great surprise to non-contract firms, such as those just quoted, whose secondary market activities have all but disappeared since mandatory price maintenance was imposed in 1940. Moreover, SEC enforcement history flatly contradicts the appellant's view. According to the SEC, Section 22(d) unquestionably bars non-contract dealers from making secondary market sales to investors at less than the public offering price established by prospectus for primary distribution sales.[115] This is a clear administrative statement by the government agency most expert in the area that Section 22(d) was intended in 1940 to have a direct and destructive impact on secondary markets.

An assistant director of the SEC's mutual fund regulatory division has written:

> Although the reasons for section 22(d) were not articulated by its proponents at the legislative hearings, the objectives of the provisions were well known in the industry and to the Commission. These objectives have been described as (1)

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[114] Appellant's concession that "non-contract dealers are bound by the requirements of Section 22(d)" (J.B. 7 n.7) does not candidly disclose that that provision binds them in true "secondary level transactions," *i.e.*, where the non-contract dealer buys from one investor and sells to another.

[115] *E.g.*, 1974 Mutual Fund Report at 118-121; 1972 Section 22(d) Report, Pt. I, F.Sec. L. Rep. Report No. 450, Pt. II at A-109; 1966 Public Policy Report at 220; Hearings on H.R. 9510, H.R. 9511 Before the Subcomm. of the House Comm. on Interstate & Foreign Commerce, 90th Cong., 1st Sess. at 48 & 701 (SEC Chairman Cohen) (1967) ("1967 House Hearings"); Hearings on S.1659 Before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. at 25 (1967) (SEC Chairman Cohen) ("1967 Senate Hearings").

> to insure the orderly distribution of open-end investment company shares, (2) to prevent discrimination or preferential treatment in price among members of the public, and (3) to prevent the cut-price competition which had then been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms. In this connection the Commission's Investment Trust Study Report had described a so-called "bootleg" market.[116]

The SEC relied upon this historical explanation in its 1963 Special Study of Securities Markets.[117]

In rulemaking, enforcement, and exemption actions, the SEC has adopted the view that, *inter alia,* Section 22(d) was intended to prevent competitive inroads on the regular distribution system.[118] It has adhered to that view in its reports to Congress. For instance, in a written statement submitted in 1967 to the House subcommittee which was considering the proposed repeal of Section 22(d), the SEC left no doubt that the adverse impact of secondary market competition was, in the Commission's words, a "factor in the decision to give statutory sanction to price fixing in 1940 * * *."[119] The SEC explained:

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[116] Greene, "The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940," 37 U. Det. L.J. 369, 371 (1960) (footnotes omitted).

[117] 1963 Special Study at 98 n.12.

[118] See, *e.g., Adoption of Rule N-22D-1*, Inv. Co. Act Rel. No. 2798 (1958), F. Sec. L. Rep. ¶ 76,625 at p. 80,393; *In re Sideris,* Exch. Act Rel. No. 8816 at p. 2 (1970); *Investors Diversified Services, Inc.,* Inv. Co. Act Rel. No. 3015 (1960), F. Sec. L. Rep. ¶ 76,699 at p. 80,620.

[119] 1967 House Hearings at 59.

Section 22(d) of the Investment Company Act has undoubtedly done much to shape the mutual fund industry into its present form.

* * *

Such competition as existed in the pre-1940 period seems to have had a truly disruptive effect on the relations between principal underwriters and dealers for two reasons. First, contract dealers were obligated to sell fund shares at the sales loads set by their principal underwriters while non-contract dealers were free to set their own price. Second, in those days principal underwriters kept more of the total sales load than they do now. * * * Because of these higher underwriting spreads, non-contract dealers were able to obtain shares either directly from investors or from over-the-counter trading firms at prices somewhat lower than the prices that contract dealers had to pay to the principal underwriters, which gave an incentive to dealers to cancel their contracts with principal underwriters.[120]

In a 1972 report to Congress, the SEC observed:

[T]he so-called "bootleg market" performed the service of distributing mutual fund shares at a lower cost than contract dealers. *Elimination of that market was considered to be a major motivation behind the enactment of Section 22(d).*[121]

It is misleading, therefore, for appellant to contend that the SEC "has recognized that Section 22(d) does not prohibit, but indeed *favors,* transactions in the secondary market at competitively fixed prices * * *." J.B. 40 (emphasis added).

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[120] *Id.* (emphasis added).

[121] 1972 Section 22(d) Report, Pt. II at 292.

4. *The SEC Has Interpreted Section 22(d)'s Purposes To Be The Protection Of The Primary Distribution System And The Prevention Of Investor Discrimination, Which Purposes Would Be Contravened By A Cut-Price Brokerage Market.*

The historical purposes of Section 22(d) are twofold: (i) insulation of the primary distribution system from disruptive secondary market price competition and (ii) prevention of discrimination in the offering prices available to similarly situated investors, whether in primary or secondary market transactions. The court below made such a finding. J. App. 346, 348-49. Innumerable SEC decisions endorse that finding. For instance, in adopting its Rule 22d-1, 17 C.F.R. § 270.22d-1, the SEC said unequivocally in 1958:

> The purposes of this section are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus.[122]

The SEC has employed identical language several times.[123] In 1960 the Commission said:

> It is the purpose of Section 22(d) to prevent discrimination among purchasers of redeemable investment company shares and to prevent the purchase of such shares by dealers on the [sec-

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[122] *Adoption of Rule N-22D-1*, Inv. Co. Act Rel. No. 2798 at 1 (1958), F. Sec. L. Rep. ¶ 76,625 at p. 80,393.

[123] *E.g., Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 at 4 (1972); *In re Sideris*, Exch. Act Rel. No. 8816 at 2 (1970); *Investors Diversified Services, Inc.*, Inv. Co. Act Rel. No. 3015 (1960), F. Sec. L. Rep. ¶ 76,699 at p. 80,620.

> ondary] market and their resale at a price below the current offering price.[124]

In 1963, the Commission held that "An important objective of Section 22(d) * * * is to prevent discrimination or preferential treatment in prices." [125] In 1970, the Commission said "Section 22(d) seeks to prevent the adverse effect upon investors generally which would result from discriminatory pricing and disorderly distribution." [126]

This SEC understanding of Section 22(d)'s purposes is plainly at odds with the appellant's interpretation. Moreover, the unrestrained secondary brokerage market envisioned by the appellant would substantially undermine these two purposes of Section 22(d). As the District Court found, "It is an economic fact, recognized by Congress, that the two markets—the primary market * * * and a secondary market *as urged by the plaintiffs*—cannot co-exist and both remain viable." J. App. 346 (emphasis added).[127] Price pressure from a vibrant brokerage market would compel funds to reduce sales loads. That, in turn, would diminish dealers' incentives to push fund

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[124] *Variable Annuity Life Ins. Co. of America*, Inv. Co. Act Rel. No. 2974 (1960), F. Sec. L. Rep. ¶ 76,688 at p. 80,599.

[125] *Midamerica Mutual Fund, Inc.*, 41 S.E.C. 328, 331 (1963).

[126] *In re Sideris, supra* at 2 (1970). On the discrimination point, see also Inv. Co. Act Rel. No. 89 (1941).

[127] Contrary to appellant's assertion (J.B. 39-40), the SEC's 1974 Mutual Fund Report hardly concedes that the unrestricted brokerage market sought in appellant's prayer for relief would not fatally disrupt the primary distribution system. The Report proposes a much more limited "matching" market, encumbered by numerous "safeguards" to ensure against any disruptive competition between markets. See pages 102-04, *infra*.

shares or even to continue as contract retailers because of the potentially unrewarding nature[128] and riskiness[129] of the whole undertaking. In a steadily declining stock market, with fewer and less-motivated fund dealers to counter redemption pressures, funds could expect a worsening net redemption situation and some could conceivably experience involuntary liquidation.

The brokerage market sought by appellant would also foster discrimination among investors who, on a given day, purchase identical quantities of shares in

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[128] Once a contract dealer educates a potential investor to the advantages of mutual fund investment and gives him a prospectus, the dealers' selling efforts are deemed to be a "sale" and Section 22(d) applies to any further dealings with that investor. See page 49, *supra* Under appellant's theory, the actively soliciting dealer would, concurrent with his solicitation, have to inform the investor about a possible cut-price purchase in the secondary market. Yet, that dealer would be prevented by Section 22(d) from effecting such a secondary market transaction for the customer. The prospective purchaser could then turn to another broker-dealer who has not engaged in a technical "sale" as to him. The original dealer's selling efforts would go uncompensated while the second broker-dealer effects a "match" in the secondary market.

[129] A broker-dealer has the fiduciary obligation to promptly secure for his purchasing customers the lowest price available. *Kidder Peabody & Co.*, Exch. Act Rel. No. 8426 (1968), F. Sec. L. Rep. ¶ 77,618 To abide by this "best execution rule" the dealer would have the impossible task of comparing an unknown price with a frequently unavailable price. (The primary market price is unknown until after the close of the stock exchanges. 17 C.F.R. § 270.22c-1. The secondary "market" price is unavailable during the day until a selling investor fortuitously appears in that "market" with an identical lot of fund shares to sell.) In a rapidly fluctuating portfolio market, the dealer might "match" two of his customers during the day and find, by the close, that one or the other of the customers, or both, could have done better in the primary distribution-redemption market. This is but one of many legal and practical dilemmas to which broker-dealers would be exposed.

a particular fund. The sophisticated investor with up-to-the-minute information on portfolio values would know precisely when to go into the secondary brokerage market instead of the primary market for his purchases. If lucky, he could obtain a preferential price via a secondary brokered "match" while less sophisticated purchasers would pay that day's fixed public offering price. As the District Court found (J. App. 348-49), such discriminatory results are contrary to Section 22(d)'s intent.[130]

5. *Section 22(d)'s Principal Purpose Is Not Anti-Dilution*

The appellant brushes off Section 22(d) by contending that the price maintenance requirement "was enacted to protect open-end mutual fund investors against *dilution* of their equity due to 'in-and-out' trading by *insiders*." J.B. 32-3 (emphasis added). In 1940, funds generally based the net asset value portion of the fund share selling price on the *previous* day's stock exchange quotations for portfolio securities. Those who could purchase fund shares without paying the additional sales load — underwriters, dealers, and in very rare cases, individual insiders— might buy their shares one day, sell the next, and, in effect, steal a portion of the fund's assets and thereby "dilute" the longer-term holdings of others.[131] By

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[130] Contrary to appellant's contention (see J.B. at 39 n.35), the discrimination need not be "by the fund," in the sense that the shares in both transactions be taken down from the fund concurrently, in order to contravene Section 22(d). It is enough that contract dealers, plainly bound by Section 22(d), effect the discriminatory treatment of two similarly situated purchasers of fund shares.

[131] On Tuesday, the offending diluters would pay into the fund the cash equivalent of Monday's lower asset value for Tuesday's

forcing individual "insiders" to pay the sales load, Section 22(d) inevitably contributed to the elimination of dilution as a problem.[132] But this incidental effect of Section 22(d) on dilution affords no proper basis for ignoring the principal, historical objectives of Section 22(d). This is so for three reasons.

First, Section 22(a) and 22(c) of the Act already adequately handled the dilution problem.[133] Section 22(a) of the Act authorized the NASD to make rules respecting (1) the method of price computation in sales, redemptions, and repurchases of fund shares and (2) the minimum holding period for such shares. In Section 22(a)'s words, such NASD rules would be "for the purpose of eliminating or reducing so far as reasonably practicable any *dilution* of the value of other outstanding securities [of the fund] * * * or any other result of such purchase, redemption, or sale which is unfair to holders * * *." (Emphasis added.) Section 22(c) of the Act gave the SEC authority, beginning one year after the Act's effective date, to issue superseding rules "covering the same subject matter and for the accomplishment of the same ends

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higher asset value and, on Wednesday, would redeem for the cash equivalent of Tuesday's asset value.

[132] Section 22(d) had *no* effect on underwriters' and dealers' ability to engage in diluting transactions, since *it* did not require them to pay the sales load. But *cf.* Section 22(a) described above.

[133] Section 22(a) of the original SEC draft bill would have given direct dilution-eliminating authority to the SEC. See S.3580 § 22 (a), and H.R. 8935 § 22(a), 76th Cong. (1940). The enacted bill, however, turned over the initial dilution rulemaking authority to the NASD and reserved ultimate authority to the SEC. See page 94, *infra*. Section 22 of S.3580, the SEC's 1940 draft bill, is reprinted in the Addendum at Add. 16-17.

* * *" as prescribed in Section 22(a). Thus, Sections 22(c) and 22(a) provided the SEC and the NASD, respectively, *full* rulemaking power to eliminate dilution-causing transactions. In 1941, the SEC approved NASD Rule 26 which tackled the dilution problem from several angles and radically reduced the potential for dilution by requiring *twice-daily* pricing. The SEC has now totally eliminated dilution by requiring *forward* pricing.[134]

Second, as even the appellant recognizes, "[a] *secondary* market could not contribute to dilution, whether by insiders or other investors * * *." J.B. 33 (emphasis added). Dilution was a *primary* market problem. Section 22(d) would not have imposed *secondary* market restrictions if its sole objective in 1940 were to eliminate cut-price opportunities for purchasing insiders who abused the *primary* market's then-existing pricing system. Were that the objective, the pro-

[134] Although Section 22(a) spoke of establishing a calculation method applicable to the price at which a "member" of the NASD might purchase or sell, nevertheless if the NASD were to promulgate a pricing method for transactions by member dealers and underwriters, such a method would in a practical sense inevitably cause the fund to adopt that method in its transactions with individual insiders as well as members. Similarly, Section 22(c), as it existed from 1940 to 1970, spoke only of rules "applicable to principal underwriters of, and dealers in," fund shares. Nevertheless, in its 1968 promulgation of Rule 22c-1, 17 C.F.R. § 270.22c-1, the SEC made its anti-dilution forward-pricing rule applicable to investment companies as well as underwriters and dealers. *Adoption of Rule 22c-1,* Inv. Co. Rel. No. 5519 (1968), F. Sec. L. Rep. ¶ 77,616. Though Congress in 1970 eliminated any ambiguity in the matter by inserting the words "registered investment companies" into Section 22(c) (see Section 12(b), Pub. L. No. 91-547 (1970)), Congress agreed with the SEC that the funds' potentially asset-diluting direct dealings with investors had always been encompassed by Section 22(c). H.R. Rep. No. 91-1382, 91st Cong., 2d Sess. 30-1, 54-5 (1970).

vision would have addressed only insiders and their *primary* market suppliers. Instead, the provision was plainly made applicable to *all* investor purchasers, insiders as well as outsiders, and their suppliers, whether dealers in the primary distribution chain or dealers in the "bootleg" *secondary* market.[135]

Third, in 1970 Congress carefully considered the proposed repeal of Section 22(d). By that time, as noted,[136] the backward-pricing system which had created the opportunity for asset-diluting transactions, was outlawed by the SEC. Since dilution was no longer possible, presumably Congress would have repealed Section 22(d)—*unless*, of course, Section 22(d)'s true purpose was *not* anti-dilution. As the next section of argument demonstrates, Congress in 1970 was fully aware of Section 22(d)'s genesis and its principal anti-competitive and anti-discriminatory purposes. Congress reaffirmed those purposes, did not discuss any anti-dilution purpose, and chose not to repeal Section 22(d).

6. *In 1970, Congress Rejected Repeal of Section 22(d) and Reaffirmed that Provision's Anti-Competitive, Anti-Discriminatory Purposes.*

In the 1960's a series of SEC studies and reports precipitated the first serious Congressional review of the Investment Company Act in the quarter-century since its passage.[137] The Justice Department[138] and

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[135] See page 70, *infra*.

[136] See page 66, note 134, *supra*.

[137] 1966 Public Policy Report; 1963 Special Study; and Wharton Report.

[138] See 1967 House Hearings at 20, 21, 726-27; Hearings on H.R. 11995, S.2224, H.R. 13754 and H.R. 14737 Before the Subcomm. of

others[139]—but not the SEC—proposed the repeal of Section 22(d). This question was subjected to elaborate hearings and debates during four sessions of Congress. After meticulous examination of the origin, purposes, and enforcement history of Section 22(d), and its effects on competitors and investors, Congress rejected the idea of repeal.[140]

Surely, if the industry and the SEC had been misinterpreting the original intent of Section 22(d) with respect to the elimination of secondary market-caused disruption and discrimination, Congress would have taken the opportunity to either correct that misconstruction or repeal the provision.[141] Instead, Section 12(c) of the Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1314, *reenacted* Section 22(d) in full, with a technical amendment not material to this case. Congress left no doubt about its intent to insulate the primary distribution system from secondary market competition and to protect similarly situated investors from the discrimination which secondary market competition would foster.

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the House Comm. on Interstate & Foreign Commerce, 91st Cong., 1st Sess. at 135, 136 (1969) ("1969 House Hearings"); H.R. Rep. No. 91-1382 at 50-1.

[139] See, *e.g.*, 1967 House Hearings at 591 (Mr. Wallich); Hearing on S.34 and S.296 Before the Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. at 55 (Mr. Samuelson) (1969) ("1969 Senate Hearings"). And see the next footnote.

[140] In the 90th Congress, the Senate Banking and Currency Committee preliminarily recommended the repeal of Section 22(d), but then reversed itself. See 1969 Senate Hearings at 19; 113 Cong. Rec. 23055-056 (Sen. McIntyre) (1968). In the 91st Congress, the Committee rejected Senator McIntyre's repeal proposal, S.296. See S. Rep. No. 91-184, 91st Cong., 1st Sess. (1969).

[141] See *N.L.R.B. v. Bell Aerospace Co.,* 416 U.S. 267, 275 (1974) and cases cited therein.

On numerous occasions in the late 1960's witnesses reminded Congress that Section 22(d) created a "special exception from the antitrust laws."[142] The comprehensive SEC report which had precipitated the Congressional inquiry said, "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing."[143] In urging repeal, the Justice Department advised "that Congress, in originally enacting the 'fixed price' provisions of section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws."[144] The SEC's Chairman explained that Section 22(d) was a more drastic departure from antitrust policy than the so-called "fair trade" laws which leave the initiative for the creation and civil enforcement of price maintenance to the manufacturer.[145] And, witnesses repeatedly reminded Congress that a willful violation of Section 22(d) was a *federal crime* regardless of the particular mutual fund's or underwriter's attitude toward price fixing in that fund's shares.[146]

Congress was told about the secondary "bootleg" market which existed prior to the passage of Section

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[142] 1967 Senate Hearings at 87 (SEC Chairman Cohen); see, *e.g.*, 1967 House Hearings at 109, 156, 673, 691, 701, 707. See 113 Cong. Rec. 23056 (1968) (Sen. McIntyre).

[143] 1966 Public Policy Report at 218.

[144] 1967 House Hearings at 21.

[145] 1967 Senate Hearings at 25, 86; 1967 House Hearings at 140, 707; 1966 Public Policy Report at 222.

[146] 1967 Senate Hearings at 25-6, 86; 1967 House Hearings at 48, 109, 140. See H.R. Rep. No. 91-1382 at 3, 62; S. Rep. No. 91-184 at 7-8; S. Rep. No. 1351, 90th Cong. 2d Sess. at 7 (1968); 113 Cong. Rec. 23051 (Sen. Sparkman), 23055 (Sen. McIntyre), 23057 (Sen. Magnuson) (1968).

22(d) and was reminded that the Section had been enacted in order to eliminate price competition from such a market.[147] The SEC stated that Section 22(d) applies to secondary market activity in already outstanding shares, as well as to primary distribution of just-issued shares.[148] Congress heard repeatedly that, as a result of Section 22(d), intrafund price competition is legally impossible[149] and that there is "a sheltered, price-protected market for merchandisers of fund shares."[150] Professor Paul Samuelson observed that "Government now makes it impossible for there to be a free secondary market in mutual funds."[151]

Congress heard extensive testimony regarding whether repeal of Section 22(d) would lead to a renewed "bootleg" market and what that would mean for the future of the fund industry.[152] Witnesses weighed the dangers of abandoning what were described as Section 22(d)'s purposes—insulation against disruption caused by secondary market price competition[153] and prevention of investor discrimination.[154]

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[147] 1963 Special Study at 98; 1966 Public Policy Report at 219; 1967 Senate Hearings at 602-03 (NASD testimony).

[148] 1966 Public Policy Report at 218; 1967 House Hearings at 48,701; 1967 Senate Hearings at 25.

[149] 1967 House Hearings at 48, 59, 109-10, 655, 673, 691-92, 702-03, 811; 1967 Senate Hearings at 26-7, 32; 1969 Senate Hearings at 62; 113 Cong. Rec. 23051, 23057 (1968).

[150] 1966 Public Policy Report at 56.

[151] 1969 Senate Hearings at 62.

[152] 1967 House Hearings at 57-9, 586, 831; 1967 Senate Hearings at 356, 602-03; 1969 Senate Hearings at 18, 62, 65, 66, 103.

[153] 1967 House Hearings at 21, 143, 285-86, 827, 831; 1967 Senate Hearings at 216, 600, 608-09; 1969 Senate Hearings at 102, 206.

[154] 1967 House Hearings at 21, 58, 60, 113-14, 285, 294, 703, 714,

The Justice Department argued that repeal would not necessarily cause "disorder in the industry" or leave "the small and unsophisticated investor—the one most in need of protection—paying the higher price * * *."[155] The SEC disagreed. It urged the retention of Section 22(d) because of the "unsettling and unforeseeable effects which abolition of retail price maintenance might have on the broker-dealer community"[156] and because of the probable price discrimination between sophisticated and unsophisticated investors which would result.[157] SEC Commissioner Owens explained the Commission's rationale with respect to "bootleg" market competition:

> [W]e were apprehensive that as a regulatory agency we could not tell you gentlemen where a repeal of 22(d) would take us. There was apprehension and there still is, I might add, that we don't know what conditions will result in the marketplace if 22(d) is repealed.
>
> We are told that wildcatting and price-cutting will be ruinous to the industry. It well might be.[158]

SEC Chairman Cohen stressed the discrimination point:

> Thus, perhaps the very people most in need of protection would not get it from a repeal of sec-

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790-91, 827, 832-33; 1967 Senate Hearings at 608, 1186-187; 1969 Senate Hearings at 102, 206.

[155] 1967 House Hearings at 21.

[156] 1966 Public Policy Report at 223.

[157] *Id.* at 222; 1967 House Hearings at 60, 113-14, 142-43, 703, 714.

[158] 1969 Senate Hearings at 18.

> tion 22(d), which would primarily benefit the more knowledgeable and sophisticated investor who might be in a position or be advised to shop around.[159]

Thus, Congress was fully apprised of Section 22(d)'s historical background and current effects, its anti-competitive and anti-discriminatory purposes, and its unique departure from traditional antitrust policy. In rejecting repeal of Section 22(d), Congress reaffirmed the Nation's policy *against* a price-competitive, secondary market in mutual fund shares. Congress heeded the advice of Congressman Stuckey who said: "We must not return to the cutthroat retail price competition in sales charges that existed prior to the 1940 Act."[160] In reporting favorably upon what became the Investment Company Amendments Act of 1970, both the Senate Banking and Currency Committee and the House Committee on Interstate and Foreign Commerce stated unequivocally that under the amended Act, "the sales loads fixed by the principal underwriters * * * continue to be protected against price competition by section 22(d) * * *."[161]

7. *Congress Never Intended That Section 22(d) Contain a "Secondary Brokerage Market" Loophole.*

Neither the 1940 Congress nor the 1970 Congress had any reason to believe that Section 22(d) would be applied to the secondary market any less comprehensively than to the primary market. Indeed, Con-

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[159] 1967 House Hearings at 714.

[160] 116 Cong. Rec. 33283 (1970).

[161] S. Rep. No. 91-184 at 18; H.R. Rep. No. 91-1382 at 30.

gress premised its 1970 reenactment of Section 22(d) on the understanding, fully supported by SEC testimony, that the 1940 language *totally* insulates the primary system from *any* secondary market price competition.

The Senate Committee which reported favorably on Section 22(d) in 1940 spoke of it as a *blanket* prohibition with a *single, express* exception:

> In addition, provision is made to prohibit *the sale* of redeemable securities *to any person other than a dealer or principal underwriter* at a price less than that at which the security is sold to the public.[162]

When the chairman of the comparable House committee took the SEC-industry bill to the floor for a vote, he described Section 22(d) in words identical to those employed in the Senate report.[163]

Thus, when Congress voted in favor of Section 22(d) in 1940, it did so with the understanding that, whatever "the sale," the prospectus-fixed price had to be maintained. Indeed, in the context of that time, it would have been most strange if Congress had meant to bar price competition fostered by secondary market dealers, but not price competition engendered by secondary brokerage transactions arranged by dealer members of the fund distribution syndicate itself.[164]

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[162] S. Rep. No. 1775, 76th Cong., 2d Sess. at 16 (1940) (emphasis added).

[163] 86 Cong. Rec. 9811 (1940) (Rep. Cole).

[164] As the Investment Trust Study revealed, even selling group members were participating in unauthorized "bootleg market" activities prior to the Act. See page 28, *supra*.

Given the limited ways in which investors might have purchased mutual funds just prior to the 1940 Act, the industry and the Congress certainly had every reason to think that Section 22(d)'s ban on price competition was effectively *total*. The Investment Trust Study had disclosed to Congress that, in both the primary market and the secondary market in fund shares, dealers "acted as principals rather than as brokers, in practically all transactions."[165] The rare exception was where a firm acted as agent for a purchasing investor in obtaining fund shares from the underwriter, from a contract dealer, or from a secondary market dealer.[166] Of course, even in such a "brokerage transaction," the sale would originate with the underwriter or a "dealer" and would be covered by Section 22(d) whether or not the firm which purported to be acting as the investor's agent also regularly solicited other customers' purchases of that particular fund's shares.[167] This rare exception, then, was the only way investors obtained fund shares by "brokerage transactions" in 1940; and even it was clearly covered by Section 22(d).

When the Act was undergoing reappraisal in the 1960's, Congress received expert SEC testimony regarding the all-encompassing nature of Section 22(d). No SEC witness gave any credence to the possibility of a "secondary brokerage" exception for contract "dealers." Fairly read, the SEC statements were di-

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[165] Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 327.

[166] See, *e.g.*, *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 (1971); J.App. 321.

[167] *Id.*

rectly to the contrary. For instance, the SEC Chairman testified:

> The statute is unequivocal. *No person, no matter where he gets it,* from the issuer, from another dealer, or *even from a private person, no broker-dealer* may sell a share of a particular fund at a price less than that fixed by the issuer.[168]

The Chairman's use of the word "broker-dealer" signifies, of course, that he saw no loophole for "broker-dealers" acting as "brokers." At another point, he characterized the regular fund sellers, such as the appellee dealers here, as "*brokers* selling fund shares" and "*brokers* who sell fund shares."[169] In fact, the SEC consistently maintained, throughout the 1967-1970 legislative inquiry, that the Investment Company Act totally insulated the primary system from secondary market price competition by virtue of the fact that Section 22(d) made price maintenance expressly applicable to *all* secondary market sales.[170]

Others testified to the same effect. The president of the New York Stock Exchange said that Section 22(d) gives "a fund the authority to say that its shares, *whenever sold,* should carry a certain charge."[171] Professor Samuelson, whose testimony fo-

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[168] 1967 House Hearings at 711 (emphasis added). He also warned:

> If *someone* were to cut the price in the sale of the shares of a particular fund continually and deliberately, we might have the obligation of referring that to the U.S. attorney for criminal prosecution. [*Id.* at 140; emphasis added.]

[169] *Id.* at 53 (emphasis added).

[170] *E.g.,* 1967 House Hearings at 48, 701; 1967 Senate Hearings at 25.

[171] 1967 Senate Hearings at 741 (Mr. Funston) (emphasis added).

cused principally on the desirability of creating a competitive *secondary* market,[172] said Section 22(d) "prohibits a *broker* from selling mutual fund shares to the public at less than the public offering price."[173]

All of this testimony, which the District Court cited (J. App. 350), was demonstrably directed "to the application of Section 22(d) to secondary markets" despite appellant's present protestations to the contrary (J.B. 41).[174] Indeed, the appellant's own 1967 testimony in favor of repealing Section 22(d) made absolutely no reference to the supposed legality of a secondary *brokerage* market affording a degree of price competition even in the absence of repeal.[175]

The import of SEC and other expert testimony was not lost on the Congress. Senator Sparkman, chairman of the Senate Banking and Currency Committee which favorably reported the 1970 Amendments Act, said: "This Section [22(d)] now makes it a Federal crime for *anyone* to sell mutual fund shares at a price lower than that fixed by the fund's distributor."[176] Senator Magnuson observed that "mutual fund sales charges are *totally* insulated from price competition."[177]

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[172] 1967 Senate Hearings at 348, 356.

[173] *Id.* at 348 (emphasis added).

[174] Appellant dismisses this testimony and other legislative comments and reports as that of "several persons." (J.B. 13.) Appellant neglects to identify these "persons" as the Chairman of the SEC, prominent academicians, individual U.S. Senators, and the House and Senate signers of official Congressional committee reports; see pages 76-77, *infra*.

[175] 1967 House Hearings at 21.

[176] 115 Cong. Rec. 838 (1969) (emphasis added).

[177] 113 Cong. Rec. 23057 (1968) (emphasis added).

The official Senate committee reports in 1968 and 1969 declared:[178]

> Under this Section [22(d)], *all dealers, regardless of the source of the shares they sell,* are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting *in this field* is a Federal crime.

The 1970 House report used nearly identical language.[179] Plainly, it was Congress' considered judgment that dealers, such as the appellee dealers here, may not legally sell to an investor at less than the public offering price "regardless of the source of the shares they sell," whether those shares are obtained through a primary or secondary market transaction or whether the selling dealer purports to act as principal or as agent.

Appellant cites several SEC publications (J.B. 37-9) that may conflict with the understanding of Congress in 1970. These publications were not disclosed to Congress and, if anything, were contradicted by the SEC testimony upon which Congress premised its reenactment of Section 22(d). That alone prevents them from controlling this Court's interpretation of the provision. See pages 81-83, *infra*. Moreover, those SEC publications which antedated the filing of this lawsuit were so dated and obscure that they were ignored and, in effect, contradicted in the SEC staff's 375-page study of Section 22(d), published in 1972.[180]

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[178] S.Rep. No. 91-184 at 7-8; S.Rep. No. 1351 at 7 (emphasis added).

[179] H.R. Rep. No. 91-1382 at 3.

[180] 1972 Section 22(d) Report, Pt. I. The Report categorically stated:

> The absence of a [secondary] market does not hurt the mutual fund buyer. So long as 22(d) remains in effect, he has nothing to gain from an active trading market. [*Id.* at A-110.]

Except for the 1974 Mutual Fund Report, none of the SEC publications actually says that contract dealers who are regularly engaged in the solicitation and sale of mutual fund shares at the statutorily fixed price—as the appellee dealers are engaged on a daily basis—may concurrently engage in cut-price sales of those same funds' shares in a competing secondary brokerage market without violating Section 22(d).[181]

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[181] Inv. Co. Act Rel. No. 87 (1941), addressed the situation of former "bootleg" traders who were anxious to obtain some relief from Section 22(d) and who had asked the NASD to inquire at the SEC on their behalf. The SEC General Counsel responded that such a firm might avoid Section 22(d) *only* if it were "acting *solely* in the capacity of agent" for one or both investors in a pure agent-arranged investor match. (Emphasis added.) In such circumstances, the firm would not be within the statutory definition of "dealer," which presupposes *a regular business of acting for one's own account* in shares of the particular fund. See pages 45-46, *supra*. The General Counsel did not intimate that a *contract* dealer, who *is* continually engaged in such a regular business for the fund involved, could *ever* be "acting *solely* in the capacity of agent" in a sale to an investor.

Oxford Co., 21 S.E.C. 681 (1946) involved a two-man firm which had egregiously violated its special fiduciary obligations toward two elderly ladies who were practically its only customers. Because of the unique circumstances of the case, the firm was *presumed to be acting for the account of these two customers* in its transactions for them. Accordingly, the firm could not be considered a statutory "dealer." There is no evidence that the *Oxford* firm was a regular, contract dealer selling to a variety of customers, nor that the Commission intended to extend the 1941 General Counsel's opinion, *supra*, to contract dealers.

Mutual Funds Advisory, Inc., Inv. Co. Act Rel. No. 6932 (1972), was not available to Congress in 1970. Even if it had been, Congress could not have deduced therefrom that the SEC was permitting contract dealers to participate as agents in sales at less than the public offering price. In fact, the Commission did *not* allow price-cutting in *Mutual Funds Advisory:*

> As we stated in First Multifund [Inv. Co. Act Rel. No. 6700 (1971)], the sale * * * is effected through [the broker] to the

The 1974 Mutual Fund Report purports to rely upon these prior releases.. Actually it extends them for the first time to regular contract dealers. This extension is unquestionably inconsistent with the SEC's 1967-1970 Congressional testimony and Congress' 1970 understanding of Section 22(d). It is also apparently inconsistent with several relatively recent actions taken by the Commission and relied upon by the District Court (J. App. 347, 351). [182] The 1974 Mutual Fund Report does not evidence any consideration of the statutory definitions of "dealer" and "sell" (see pages 44 to 51, *supra*). Nor does the staff report attempt to square its reading of Section 22(d) with the historical

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> customer [in this case, Fundpack] . . . who pays the *current offering price as required by Section 22(d).* [*Id.* at 3; emphasis added.]

[182] In its Thirty-eighth Annual Report to Congress at 97 (1972), the Commission stated flatly, without exception, that

> Section 22(d) precludes *the sale to public investors* of redeemable investment company securities which are being currently offered to the public on or through an underwriter except at a current public offering price described in the prospectus. [Emphasis added.]

In 1971, the Commission approved new language to NASD Rule 26(e), Rules of Fair Practice, Art. III, Section 26(e), that clearly reflects the general industry and SEC understanding at that time that Section 22(d) prohibited members of the on-going primary distribution selling group from *any* participation in sales below the public offering price, regardless of the members' transactional capacity. The Rule, which is still in force and will remain so unless and until the SEC disapproves it (15 U.S.C. §§ 78o-3(k) and 80a-22(c)), says "No *member* shall offer or sell any such [mutual fund] security except at the effective public offering price * * *." (Emphasis added.) The member's purported capacity, as principal or as agent, is irrelevant. Presumably, the appellees were entitled to rely on such a rule, which the appellant rightly recognizes it may not attack (J.B. 51) and which, according to the SEC's letter to the District Court, is a matter within the "exclusive original jurisdiction" of the SEC (J. App. 323).

reasons for the provision's original enactment[183] or with the quite recent expression by Congress that the fixed sales load price of fund shares shall "continue to be protected against price competition by section 22(d) * * *."[184] Consequently, in this limited area of statutory construction, the Report is hardly authoritative.

We do not assert, however, that the SEC lacks the exclusive jurisdiction to enable contract dealers to legally act as agents in limited "genuine matching" of investors' orders. Short of obtaining a Congressional amendment of Section 22(d), the SEC might issue an exemptive order pursuant to Section 6(c) of the Act, supported by the SEC's broad authority under that provision[185] and under Section 38(a) of the Act.[186] So long as such exemptive order incorporates the regulatory safeguards against disruption of the primary distribution system, as mentioned in the 1974

[183] See pages 53 to 60, *supra*.

[184] See page 72, *supra*.

[185] See 1 L. Loss, *Securities Regulation* at 149 (2d ed. 1961).

[186] Section 6(c), 15 U.S.C. § 80a-6(c), empowers the SEC, *inter alia*, to conditionally or unconditionally exempt any person from any provision of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this Act." Thus, the SEC could conditionally free contract dealers from Section 22(d)'s price maintenance requirement to act as investors' agents in limited, genuine matching of investors' buy and sell orders. Section 38(a), 15 U.S.C. § 80a-37(a), empowers the SEC, *inter alia*, to issue rules, regulations, and orders, when necessary or appropriate, redefining terms used in the Act and prescribing different requirements in different matters. Accordingly, the SEC might define the terms "dealer" and "sell" in Section 22(d) to permit the contemplated special exemptive order for limited, brokered matches. See page 99, *infra*.

Report and in the SEC's implementing letter to the NASD,[187] the order presumably would not contravene Section 22(d)'s purposes, as originally conceived and as reendorsed by Congress in 1970. These safeguards, discussed more fully at pages 103 to 104, *infra,* should prevent the fortuitous, limited matching of non-inventoried buy and sell orders from developing into a price-competitive, secondary brokerage market similar in size, scope, and discriminatory effect to the "bootleg" market which Section 22(d) was meant to eliminate.

Whatever the SEC's exemptive authority to experiment with limited brokerage matching as part of a long-range, industry transformation program, however, the question for this Court is whether *Congress* meant to expose contract dealers to antitrust liability for agreeing not to "broker" at less than the Section 22(d) public offering price. Congress, after all, was told by the Chairman of the SEC that by reenacting Section 22(d), which applies to both primary and secondary markets, Congress was ensuring that "no matter where he gets it * * *, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer."[188]

Congress reenacted Section 22(d) on the basis of this authoritative SEC testimony and in the face of Justice Department pleas that the section be repealed so that a broker-dealer *might* legally sell "at a price less than that fixed by the issuer." In this setting, the SEC interpretation upon which Congress relied should control in interpreting the meaning of the re-

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[187] Garrett letter, Add. 18-19.

[188] 1967 House Hearings at 711.

enacted provision. As this Court said last Term, "In these circumstances [of Congressional reenactment after careful appraisal of an agency interpretation] congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress." *N.L.R.B.* v. *Bell Aerospace Co.,* 416 U.S. 267, 275 (1974). See, *e.g., N.L.R.B.* v. *Gullett Gin Co.,* 340 U.S. 361, 366 (1951); *Massachusetts Mutual Life Insurance Co.* v. *United States,* 288 U.S. 269, 273 (1933); see also *Flood* v. *Kuhn,* 407 U.S. 258, 283-84 (1972); *State Board of Insurance* v. *Todd Shipyards Corp.,* 370 U.S. 451, 457-58 (1962).[189] This rule of construction applies even if the administrative interpretation relied upon by Congress arguably varies from prior administrative interpretations. See *Alstate Construction Co.* v. *Durkin,* 345 U.S. 13, 16-17 (1953). In any event, Congress' 1970 understanding of the provision it was reenacting prevails over the apparent SEC staff change

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[189] The situation here is altogether different from that in *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321, 348-49 (1963) cited by appellant (J.B. 41). There the Court properly concluded that it should not interpret a 1950 amendment on the basis of views voiced by a few Congressmen and Justice Department spokesmen several years *after* the amendment. Here the SEC interpretation of Section 22(d) was voiced *during* the reenactment process and relied upon by Congress *at that time.*

Appellant's reference (J.B. 41) to *S.E.C.* v. *Capital Gains Research Bureau,* 375 U.S. 180 (1963), is likewise inapposite. The issue there was not one of contemporaneous agency interpretation of a statute undergoing reenactment. Rather, the Court had before it the unpersuasive argument that the 1960 amendments to the Investment Advisers Act of 1940, adding "manipulative" practices to the original ban on "fraudulent" and "deceptive" practices, somehow narrowed the scope of the ban as to the latter practices. The 1960 legislative history was devoid of any administrative or Congressional support for such an argument.

of position in 1974. See *N.L.R.B.* v. *Bell Aerospace Co., supra,* 416 U.S. at 275, 288 (1974).

8. *Congress in 1970 Adopted An Antitrust-Exempt Self-Regulatory Scheme To Control "Excessive" Sales Loads And To Encourage Inter-Fund Price Competition.*

In 1970, while retaining Section 22(d)'s complete insulation of mutual fund shares from *intra*-fund price competition, Congress simultaneously amended Section 22(b) of the Investment Company Act in order to encourage *inter*-fund price competition. This is highly significant, since the appellant's confessed objective in attempting to impose by litigation a "brokerage transaction" loophole in Section 22(d) is to force down primary market sales loads via price pressure from a secondary market.[190] Yet, in 1970, Congress categorically refused an invitation to tamper with Section 22(d) as a way of reducing sales loads through competition. Instead, Congress gave the industry a mandate to *regulate,* with SEC oversight, against excessive sales loads. Congress expressly exempted that self-regulatory process from anti-trust scrutiny.

In 1966, the SEC had reported that load mutual funds tended to compete for the *salesman's* interest by *raising* sales loads rather than the *investor's* interest by *lowering* sales loads.[191] Although price competition *between* funds was not insubstantial,[192] the SEC believed that the *intra*-fund price-fixing feature of

[190] Complaint ¶ 59(b), J.App. 17.

[191] 1966 Public Policy Report at 56.

[192] See page 88, footnote 202, *infra*.

Section 22(d), along with other factors, had contributed to excessively high sales loads and less vigorous, investor-oriented *inter*-fund price competition. The SEC proposed that the Investment Company Act be amended to impose a 5% ceiling on sales loads and to empower the Commission to vary the ceiling by rule, regulation, or order.[193] The industry, which relies heavily upon underwriter promotion and dealer salesmanship, argued that such a drastic reduction in underwriter and dealer compensation would have destroyed the industry.[194] For the time being, at least, Congress agreed.

Section 12(a) of the Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1314, substantially amended Section 22(b) of the 1940 Act and renumbered it as Section 22(b)(1). The original provision had empowered the NASD to issue rules regarding only the "unconscionable or grossly excessive sales load," but new Section 22(b)(1) deleted the words "unconscionable or grossly." The amended provision, however, added the requirement that any NASD sales load rule "shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters * * *." Congress had heard extensive testimony regarding the importance of promotion, solicitation, and investor education to the proper functioning of the funds' continuous distribution process and the concomitant need for adequate sales loads to finance that effort. As the Senate Banking and Currency Committee said:

> In reporting this bill, your committee recognizes the importance of permitting adequate com-

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[193] 1966 Public Policy Report at 223.

[194] *E.g.*, 1967 House Hearings at 274 *et seq.*

> pensation and incentives so that men of ability and integrity will continue to be attracted to the mutual fund industry.[195]

The 1970 amendment empowered the SEC, after eighteen months, to alter or supplement the NASD's Section 22(b)(1) sales load rules "as may be necessary to effectuate the purposes of this subsection * * *." Section 22(b)(3), 15 U.S.C. § 80a-22(b)(3). Clearly, the maintenance of adequate sales incentives is one of the "purposes" of Section 22(b).[196]

The Maloney Act provision[197] which forbids the NASD from adopting rules "to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges" is made *expressly inapplicable* in the sales load context by Section 22(b)(1). And Section 22(b)(4), also added by the 1970 amendment, says:

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. [15 U.S.C. § 80a-22(b)(4).]

The committee reports explained:

> This provision which is identical to section 15A(n) of the [Maloney amendment to the] Securities Exchange Act, is designed to make it

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[195] S. Rep. No. 91-184 at 4.

[196] Another new provision, Section 22(b)(2), empowers the SEC, after eighteen months, to adopt similar sales load rules to govern nonmembers of the NASD, but permits nonmembers to elect to be governed by the NASD's rather than the SEC's sales load rules. 15 U.S.C. § 80a-22(b)(2).

[197] Section 15A(b)(8) of the 1934 Act, 15 U.S.C. § 78o-3(b)(8).

> clear that no other provisions of Federal law, *including the antitrust laws,* prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section.[198]

In conclusion, it is evident that Congress intended to regulate excessive sales loads (and, in that sense, *inter*-fund price competition) through the existing NASD-SEC framework of cooperative regulation, *not* through the antitrust laws. Indeed, the decision to regulate sales loads in this fashion and, at the same time, to continue Section 22(d)'s absolute ban on *intra*-fund price competition are part of a Congressional policy judgment totally inconsistent with the rationale behind the present lawsuit.

III. THE SEC EXERCISES PERVASIVE REGULATORY AUTHORITY OVER THE CONDUCT IN QUESTION AND, ACCORDINGLY, THAT CONDUCT MAY NOT BE CHALLENGED UNDER THE ANTITRUST LAWS.

As we have seen, Sections 22(f) and 22(d) reject the usual antitrust policies against fixed prices and transferability restrictions. Section 22(f) is sufficient basis in itself for this Court to affirm the dismissal below of all secondary dealer and brokerage market claims; and Section 22(d) would warrant affirming the dismissal of the secondary brokerage market claims. In addition, as the court below found (J. App. 355-61), the specific conduct challenged by the complaint is governed by an *implied* antitrust immunity based upon the pervasive statutory and regulatory setting in which that conduct occurred.

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[198] S. Rep. No. 91-184 at 18; H.R. Rep. No. 91-1382 at 30 (emphasis added).

This Court recognized in *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 385 n.14 (1973), that a comprehensive "statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances by implication grant immunity from an antitrust claim."[199] As in *Hughes Tool* and similar controversies,[200] the present case is one of those "particular and discrete instances." The precise matters alleged are entrusted to the exclusive jurisdiction of the SEC, which currently has them under very active consideration.

The District Court expressly eschewed (J. App. 361) any holding that the Investment Company Act (or its companion federal securities laws) "completely displaces the antitrust laws" from all possible conduct respecting mutual funds. That question was not before the District Court and, of course, is not presented in this appeal.[201] The District Court's calculatedly narrow holding does not, despite appellant's exaggerated advocacy to the contrary, "oust the antitrust laws from the entire area" involving mutual funds (J.B. 56), nor accord "a general immunity from those laws" (J.B. 57), nor even supply an antitrust exemption for "all possible restraints in the distribution and sale of mutual fund shares" (J.B. 3). For example, the

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[199] Accord, *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 126 (1973), *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213, 219-20 (1966); *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 360-61 (1963); *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296, 304-05 (1963); *United States* v. *Borden Co.*, 308 U.S. 188, 200 (1939).

[200] See pages 109-15, *infra*.

[201] Compare *Carnation Co.* v. *Pacific Westbound Conference*, *supra*, 383 U.S. at 217 (1966).

complaint did not allege horizontal restrictions upon *inter*-brand competition, *i.e.,* competition *between* funds.[202] No defendant suggested below, and no appellee need contend on this appeal, that a covert, horizontal agreement to fix identical sales loads for various funds would necessarily be exempt from antitrust challenge.[203]

The District Court was well aware (J. App. 361) of this Court's oft-expressed view that implied displacement of the antitrust laws may be found only where direct antitrust enforcement is plainly inconsistent with the regulatory scheme. Accordingly, the District Court deliberately confined its holding to a "limited antitrust exemption" in the "narrow area" of conduct encompassed by this case. J. App. 361. It did so only after a painstaking examination of the broad panoply of quasi-legislative and quasi-judicial powers vested in the SEC by statute and a thorough documentation of that agency's pervasive exercise of such powers. J. App. 336-45, 358-59. The subsequent release of the SEC's 1974 Mutual Fund Report

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[202] Vigorous and unfettered inter-brand price competition has always existed among the load funds themselves; between high, low, and no-load funds; and between open-end funds, closed-end funds, and other investment media. 1974 Mutual Fund Report at 20 *et seq.*

[203] Section 22(b)(1) of the Investment Company Act, as amended, 15 U.S.C § 80a-22(b)(1), however, does permit the NASD, through the collective action of its officers, committees, and members, to promulgate rules regulating the size of sales loads. These rules, which will have an obvious price-fixing effect, are subject to SEC review, disapproval, supplementation, alteration, and supersession. 15 U.S.C. §§ 78o-3(k), 80a-22(b)(3), and 80a-22(c). Such collective NASD action, despite its horizontal price-fixing character, is expressly immune from antitrust challenge. 15 U.S.C. §§ 78o-3(n) and 80a-22(b)(4). See pages 85-86, *supra,* page 95, *infra.*

confirms the wisdom of the District Court's decision to leave the matters alleged in the hands of the SEC's experts, who are uniquely qualified to resolve the complex regulatory issues at stake.

In previous cases of this sort, the Court has examined (1) the character, objectives, and pervasiveness of the Congressionally established regulatory scheme; (2) whether the conduct at issue is covered by that scheme and is in fact subject to the agency's authority; and (3) whether there is a direct conflict between the agency's exercise of its regulatory control and judicial application of the antitrust laws. Where a pervasive regulatory system actively governs the precise conduct at issue and irreconcilably conflicts with the antitrust laws, this Court has consistently found an implied Congressional intent to displace the antitrust laws. *E.g., Hughes Tool Co.* v. *Trans World Airlines, Inc., supra; Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296 (1963).[204] In the instant case there *is* such a pervasive scheme, the SEC *is* actively regulating the very conduct at issue, and there *is* an irreconcilable conflict with the antitrust laws.

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[204] Appellant sets out its own criteria for implied immunity (J.B. 56) as if they were the inflexible requirements of this Court, which they clearly are not. Among other things, we take exception to the idea that the specific immunized conduct must always be the subject of an agency "proceeding," as such. That was not required in either *Hughes Tool* or *Pan American,* both *supra.* In any event, the on-going SEC implementation of its 1974 Report, coupled with other proposals, is surely in the broad sense a "proceeding" involving agency "remedial powers." Nor has this Court ever required that the agency possess *express* immunizing authority. If express immunity exists, the *implied* immunity question does not even arise. Certainly, it is possible for a subsequently enacted regulatory scheme to displace the antitrust laws *by implication alone.* *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 360-61 (1963).

A. The SEC Administers A Pervasive Regulatory System

We take exception to the appellant's assertion that in earlier cases, this Court was "faced with regulatory schemes more extensive and intensive than the present one * * *." J.B. 56. If anything, this is the most "extensive and intensive" regulatory scheme the Court has yet faced in an antitrust suit. The SEC has long been both mother and father to the mutual fund industry. It has carefully sheltered and nurtured the industry for thirty-five years. It has sharply disciplined its abuses. It has issued detailed rules, regulations, guidelines, and forms to control the industry. It is presently undertaking the orderly introduction of a limited degree of intra-brand price flexibility in mutual fund transactions. In sum, as the SEC told Congress in November, 1974, "No issuer of securities is subject to more detailed regulation than a mutual fund."[205] It is wholly misleading, therefore, to say that "underwriters, brokers and dealers are free to determine for themselves what is necessary for regulation of the mutual fund distribution network * * *." J.B. 54. As we explain below, such freedom from SEC control has not obtained since the passage of the Investment Company Act in 1940.

1. Filings at the SEC

Under the 1940 Act, a mutual fund must file a fund registration statement with the SEC in accordance with the SEC-prescribed form.[206] The statement must describe the method "to be followed by the registrant in determining the price at which its securities will

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[205] 1974 Mutual Fund Report at v.

[206] Section 8(b) of the 1940 Act, 15 U.S.C. § 80a-8(b); 17 C.F.R. §§ 270.8b-10 & 274.11; Form N-8B-1.

be offered to the public, redeemed, or repurchased," furnish a specimen "price make-up sheet," state applicable sales load percentages, and describe any dividend reinvestment requirements.[207] SEC Guidelines provide sample "acceptable responses" on such matters as pricing, sale, redemption, and repurchase.[208]

Specimens of the fund's current agreement with its principal underwriter and the underwriter's current agreement with the fund's dealers—the very agreements involved in this case—also must be included in the registration statement.[209] To keep this information "reasonably current," the fund's registration statement must be updated quarterly[210] and annually.[211] Consequently, any change in the fund-underwriter and underwriter-dealer agreements must be included in the next quarterly and annual reports.

Periodic and annual reports to the fund's security holders must be filed promptly with the SEC.[212] Copies of all mutual fund sales literature intended for distribution to prospective investors, including the prospectus, also must be filed with the SEC.[213] The

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[207] General Instructions as to Form N-8B-1, Item 30, 3 F. Sec. L. Rep. ¶ 51,293 at p. 39,263.

[208] Investment Co. Act Rel. No. 7221 (1972), 3 F. Sec. L. Rep. ¶ 51,301 at pp. 39,295 to 39,297.

[209] Instructions as to Exhibits to Form N-8B-1, 3 F. Sec. L. Rep. ¶ 51,296 Item 6.

[210] Section 30(b)(1) of the 1940 Act, 15 U.S.C. § 80a-29(b)(1); 17 C.F.R. §§ 270.30b1-1 & 274.106; Form N-1Q.

[211] Section 30(a) of the 1940 Act, 15 U.S.C. § 80a-29(a); 17 C.F.R. §§ 270.30a-2(a) & 274.101; Form N-1R.

[212] Section 30(b)(2) of the 1940 Act, 15 U.S.C. § 80a-29(b)(2); 17 C.F.R. § 270.30b2-1.

[213] Section 24(b)(1) of the 1940 Act, 15 U.S.C. § 80a-24(b)(1).

content of such sales literature is carefully controlled by the SEC's comprehensive Statement of Policy,[214] which is currently under study for possible revision.[215]

Under the 1933 Act a mutual fund must register its securities with the SEC prior to issuance and must keep that registration statement current as long as the fund continuously sells shares.[216] The 1940 Act provides that, in lieu of the usual 1933 Act registration statement, the fund may submit the registration statement and periodic reports required to be filed under the 1940 Act, plus such additional information as the SEC may require.[217] The SEC-prescribed form[218] requires inclusion of, *inter alia,* a current prospectus disclosing the same comprehensive information on pricing and sales load percentages as required by the 1940 Act registration form.[219] The SEC's prospectus guidelines set out detailed disclosure requirements with respect to such topics as "how to purchase the company's shares," "pricing for sales," "sales charge," and "repurchase, redemption, and market for shares."[220] The 1933 Act filing also must contain specimens of the fund-underwriter and underwriter-dealer agreements employed in the sale of fund shares.[221] To keep "reasonably current," changes in

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[214] 3 F. Sec. L. Rep. ¶ 48,902.

[215] See Inv. Co. Act Rel. No. 8571 (1974), F. Sec. L. Rep. ¶ 80,001.

[216] Section 6 of the 1933 Act, 15 U.S.C. § 77f.

[217] Section 24(a) of the 1940 Act, 15 U.S.C. § 80a-24(a).

[218] Form S-5; see 17 C.F.R. § 239.15.

[219] General Instructions as to Form S-5, 1 F. Sec. L. Rep. ¶¶ 7172, 7173.

[220] 1 F. Sec. L. Rep. ¶ 7178 at pp. 6299-15 to 6299-20.

[221] Instructions as to Exhibits to Form S-5, ¶ 1, 1 F. Sec. L. Rep. ¶ 7177.

any aspect of the 1933 Act registration statement, including the prospectus and the agreements, must be indicated in quarterly and annual reports filed under the 1934 Act.[222] The 1940 Act periodic report forms are used.[223] Through deregistration and lesser sanctions under both Acts, the SEC is able to ensure that the documents filed with it accurately portray, and do not actively distort, the market for and pricing of mutual fund shares.[224]

2. SEC Control of NASD Rules

The Maloney Act grants the NASD broad powers to issue rules affecting over-the-counter transactions,

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[222] Sections 14(a) & 15(d) of the 1934 Act, 15 U.S.C. §§ 78m(a) & 78o(d); 17 C.F.R. §§ 240.13a-12, 240.15d-1, & 240.15d-12.

[223] 3 F. Sec. L. Rep. ¶¶ 51,961 to 51,985, ¶¶ 52,102 to 52,104.

[224] If the SEC finds that a 1940 Act registration statement or report "omit[s] therefrom material facts" or "makes any untrue statement of a material fact" or omits "to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading," the SEC may suspend or revoke the fund's registration. Section 8(e) of the 1940 Act, 15 U.S.C. § 80a-8(e), which refers to Section 34(b) of the 1940 Act, 15 U.S.C. § 80a-33(b). Deregistration effectively terminates any lawful sale of fund shares. Section 7(a) of the 1940 Act, 15 U.S.C. § 80a-7(a).

If a fund's registration statement under the 1933 Act is "on its face incomplete or inaccurate in any material respect," the SEC may delay the effective date of registration until the statement is corrected. Section 8(b) of the 1933 Act, 15 U.S.C. § 77h(b). If it appears to the SEC "at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading," the SEC may, after notice and opportunity for hearing, issue a stop order suspending the effectiveness of the registration statement and precluding further offerings of the fund's shares. Section 8(d) of the 1933 Act, 15 U.S.C. § 77h(d); see, *e.g., T.I.S. Management Corp.*, 3 S.E.C. 174 (1938); *Managed Funds, Inc.*, 39 S.E.C. 313 (1959).

including the sale of mutual fund shares.[225] The Investment Company Act gives the NASD extensive authority to promulgate rules regulating the calculation of fund share prices, holding periods, and sales loads.[226] NASD exercise of this authority is always under the continuing surveillance and control of the SEC.

To qualify as a registered association under the Maloney Act, the NASD had to file a registration statement, accompanied by its corporate charter, bylaws, and rules. The SEC scrutinized NASD rules on the basis of strict statutory requirements[227] before approving the NASD's registration in 1939.[228] Since then, the NASD has had to file periodic amendments and supplements to its registration statement and whatever information it furnishes to its members.[229] Also, the NASD has had to submit proposed rule additions or changes to the SEC. These take effect upon the thirtieth day after filing, unless the SEC issues a disapproval order.[230] The SEC may abrogate NASD rules in order to assure "fair dealing," "fair representation," or to "protect investors" and effectuate the

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[225] Section 15A(b) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(b).

[226] Sections 22(a) and 22(b) of the 1940 Act, as amended, 15 U.S.C. §§ 80a-22(a) & 80a-22(b).

[227] See Section 15A(b) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(b).

[228] *Application by Nat'l Ass'n of Securities Dealers, Inc., for Registration as a Nat'l Securities Ass'n,* 5 S.E.C. 627 (1939) ("1939 Registration").

[229] 17 C.F.R. § 240.15Aj-1.

[230] Section 15A(j) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(j).

statutory purposes.[231] The SEC may also request the NASD to alter or supplement its rules; and, if the NASD fails to comply, the SEC may order such changes itself, at least with respect to certain matters.[232] The SEC weighs competitive factors with other concerns in its continuing evaluation of NASD rules.[233] This system of Congressionally authorized, industry self-regulation, operating under the constant surveillance and control of the SEC, explicitly supplants other federal laws, including the antitrust laws.[234]

In 1941,[235] the SEC approved NASD Rule 26[236]

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[231] Section 15A(k)(1) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(k)(1); *e.g., In re Nat'l Ass'n of Securities Dealers, Inc.*, F. Sec. L. Rep. ¶ 78,831 (S.E.C. 1972), aff'd without opinion, F. Sec. L. Rep. No. 504 at 5 (D.C. Cir. 1973) ("Aetna Case").

[232] Section 15A(k)(2) of the 1934 Act, as amended, 15 U.S.C. 78o-3(k)(2). In addition to its supervision of rulemaking, the SEC may, upon application or upon its own motion, review and alter any NASD disciplinary action, denial of membership, or restriction upon rights of association with non-members. Section 15A(g) & (h); 15 U.S.C. §§ 78o-3(g) & (h). The SEC may suspend or revoke the NASD's registration, suspend or expel its members, bar persons from associating with its members, and remove any of its officers or directors. Section 15A(l), 15 U.S.C. § 78o-3(l); 17 C.F.R. §§ 240.15b7-1.

[233] *E.g.*, 1974 Mutual Fund Report at vi, 105, 109; *In re Nat'l Ass'n of Securities Dealers (Aetna Case), supra*, F. Sec. L. Rep. ¶ 78,831 at p. 81,824; *In re Nat'l Ass'n of Securities Dealers, Inc.*, 19 S.E.C. 424, 436, 486-87 (1945) *(PSI Case); Proposed Amendment to The Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.*, 9 S.E.C. 38, 43-46 (1941) *(Rule 26 Approval); Application by Nat'l Ass'n of Securities Dealers (1939 Registration), supra*, 5 S.E.C. at 632.

[234] Section 15A(n) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(n).

[235] *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.*, 9 S.E.C. 38 (1941).

[236] Art. III, Section 26, NASD Rules of Fair Practice, CCH NASD Manual ¶ 2176 (1974).

which, with a few revisions and the addition of one major paragraph, remains in force today as the principal Rule governing members' mutual fund transactions. It is through Rule 26, principally, that the NASD exercises the authority conveyed to it by Sections 22(a) and 22(b) of the 1940 Act. The Rule says that an NASD member may not purchase fund shares at a discount unless the selling underwriter is an NASD member, that a member underwriter may not sell to any non-member "dealer or broker," and that a member underwriter may not sell to any "dealer or broker" unless there is "a sales agreement" between the parties containing certain specific provisions of the Rule. (¶ (c).) The Rule states that "*No member shall offer or sell* any such [mutual fund] security *except at the effective public offering price* described in the current prospectus * * *," and adds that such offer or sale must be in accordance with SEC rules and regulations and interpretations thereunder. (¶ (e).)[237]

Rule 26 forbids withholding of customers' orders (¶ (f)(1)), and inventorying of shares (¶ (f)(2)), and bars conditional orders at indefinite prices (¶ (g)). It forbids redemptions and repurchases above net asset value (¶ (h)), requires that the sales load be returned to the fund whenever a purchaser redeems within seven days of purchase (¶ (i)), and prohibits contracting brokers and dealers from purchasing, as principal, from shareholders at less than the next-determined net asset value (¶ (j)(1)), but permits them to charge

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[237] From 1941 to 1971, paragraph (e) required members to use twice-daily, rather than once-daily, backward pricing, as a way of reducing dilution. See page 64, *supra*. In 1971, it was amended to, among other things, take account of the SEC rule, 17 C.F.R. § 270.22c-1 (effective 1969), requiring *forward* pricing.

commissions for effecting sales back to the fund (¶ (j)(3)). An SEC-approved 1973 addition to the Rule forbids reciprocal arrangements (¶ (k)). Rule 26 presently proscribes "unfair" sales loads (¶ (d)). The SEC has tentatively approved[238] an amendment which would establish specific sales load ceilings and encourage low-load and no-load purchasing opportunities.

Since 1941 the Rule has, with the SEC's blessing, directly impeded secondary market activity. Paragraph (j)(2) prohibits any member underwriter from participating in the offer or sale of fund shares if the fund voluntarily redeems or repurchases from non-contract brokers or investors who are not record owners. The provision also bars underwriters themselves from repurchasing from non-record owners. In written and oral testimony, secondary market dealers vigorously opposed paragraph (j)(2) on two grounds —(1) that it unjustly discriminated against non-contract dealers by requiring them, but not the contract dealers, to become record owners, and (2) that it impeded the transferability of fund shares in a secondary market by forcing secondary market dealers to run the risk of redemption price changes during the time necessary to become record owners. The SEC refused to disapprove Rule 26(j)(2) despite its admittedly restrictive impact on secondary market activities, and hence upon investors' opportunities to dispose of their shares in such a market. The SEC observed that Congress never intended or expected "a free and open market" for mutual fund shares because of their unique characteristics, *i.e.,* continuous distribution and redemption, and market valuation

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[238] Inv. Co. Act Rel. No. 8570 at 6 (1974), F. Sec. L. Rep. ¶ 79,998.

based not on the supply and demand for fund shares but on the supply and demand for the funds' portfolio securities.[239]

3. *SEC Rules and Exemptive Orders*

The 1940 Act entrusts the SEC with broad, almost "quasi-legislative," rulemaking and exemptive authority over the sale, redemption, and pricing of mutual fund shares. Section 12(b),[240] for instance, empowers the SEC to ensure, by rules and regulations, that funds distribute their shares through underwriters. Section 22(c),[241] *inter alia,* authorizes the SEC to issue rules governing price computation methods, holding periods, and sales loads. Section 22(e)[242] forbids funds from suspending shareholders' redemption rights and from postponing payments for more than seven days after redemption tenders, except in emergency circumstances defined by SEC rules and regulations. Section 22(f),[243] as fully described in Part I of the Argument, *supra,* entitles the SEC to prohibit, by rules and regulations, restrictions upon the "transferability or negotiability" of fund shares.

In addition to these specific rulemaking provisions, the Act contains an "elastic clause," Section 38(a),[244] which provides that the SEC shall "issue, amend, and rescind such rules and regulations and such orders

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[239] *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.,* 9 S.E.C. 38, 46 (1941).

[240] 15 U.S.C. § 80a-12(b).

[241] 15 U.S.C. § 80a-22(c).

[242] 15 U.S.C. § 80a-22(e).

[243] 15 U.S.C. § 80a-22(f).

[244] 15 U.S.C. § 80a-37(a).

as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this Act * * *." The SEC is also empowered to issue rules and regulations defining terms used in the Act and prescribing forms for use in complying with the Act.[245]

Additionally, the Act gives the SEC very broad exemptive powers. Section 6(c)[246] provides that the SEC may, conditionally or unconditionally, exempt persons, securities, transactions, or classes thereof, from any provisions of the Act or from rules or regulations thereunder, where "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this Act." Exemptions may be granted by rule, regulation, or order.

Recognizing the necessity of industry reliance upon the SEC's authority, Section 38(c)[247] provides that liability may not be imposed on any person who acts in good faith conformity with any SEC rule, regulation, or order, even though subsequently amended, rescinded, or declared invalid.

The SEC has exercised the foregoing rulemaking and exemptive authority in several ways. In 1958 the SEC adopted Rule 22d-1,[248] which in most respects codified prior Commission interpretations of Section

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[245] *Id.*

[246] 15 U.S.C. § 80a-6(c). The SEC has explicit authority to exempt funds and classes of funds from NASD sales load rules. Section 22(b)(1), 15 U.S.C. § 80a-22(b)(1).

[247] 15 U.S.C. § 80a-37(c).

[248] 17 C.F.R. § 270.22d-1.

22(d).[249] The rule permits the reduction and elimination of sales loads under certain circumstances, including, *inter alia*, volume purchases, dividend and capital gain reinvestments, and purchases by persons employed by the fund, its advisor, or its underwriter. Paragraph (h) of Rule 22d-1 was amended in 1971 to require that such persons be primarily engaged in the mutual fund aspects of the employer's business.[250]

Rule 22d-1 originally proscribed rather broadly the practice of "grouping" prospective fund purchasers to obtain volume discounts. An amendment proposed in 1968 would have lifted the anti-grouping rule.[251] In 1973, the Commission withdrew that proposal and substituted a less drastic change.[252] In November 1974, after years of studying the question and its possible effects on the delicate mutual fund distribution system, the Commission approved an amendment to Rule 22d-1 which allows the use of "bona fide" groups to obtain volume discounts. The "group" must have been in existence for at least six months, must have a bona fide purpose other than to purchase fund shares at a discount, and may not be composed of a particular company's creditcard holders, an insurance company's policyholders, or customers of a particular bank, broker-dealer, or investment adviser.[253]

Rule 22d-2[254] was promulgated in early 1974 to expand upon previously granted exemptions. It allows

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[249] Inv. Co. Act Rel. No. 2798 (1958), F.Sec. L. Rep. ¶ 76,625.

[250] Inv. Co. Act Rel. No. 6347 (1971), F.Sec. L. Rep. ¶ 77,953.

[251] Inv. Co. Act Rel. No. 5507 (1968), F.Sec. L. Rep. ¶ 77,609.

[252] Inv. Co. Act Rel. No. 7571 (1973), F.Sec. L. Rep. ¶ 79,148.

[253] Inv. Co. Act. Rel. No. 8569 (1974), F.Sec. L. Rep. ¶ 79,999.

[254] 17 C.F.R. § 270.22d-2.

reinvestment without sales charge within thirty days after a redemption of fund shares.[255] Both Rule 22d-1 and Rule 22d-2 represent efforts to codify the many SEC rulings upon Section 22(d) exemption applications filed under Section 6(c). The Commission has approved [256] and rejected [257] many such applications. Also, the Commission recently promised to (1) publish for comment a rule permitting funds to utilize "open seasons" during which persons who have held shares for a specified period might purchase specified amounts of additional shares on a reduced-load or no-load basis, (2) consider Section 22(d) exemption applications for reduced loads to unsolicited new investors, and (3) consider applications for Section 22(d) exemptions to permit sales load reductions to combination purchasers, *i.e.*, persons who have previously or contemporaneously purchased from the same retailer another investment product or an insurance product distributed by the same underwriter.[258] In 1968, pursuant to Section 22(c), the

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[255] Inv. Co. Act Rel. No. 8235 (1974), F.Sec. L. Rep. ¶ 79,649.

[256] *E.g., Continental Assurance Co.*, Inv. Co. Act. Rel. No. 7488 (1972); *Dow Theory Investment Fund, Inc.*, 38 S.E.C. 286 (1958); *Investors Diversified Services*, Inv. Co. Act Rel. No. 1504 (1950); *Axe-Houghton Fund, Inc.*, Inv. Co. Act Rel. No. 1009 (1947); F.Sec. L. Rep. ¶ 75,740.

[257] *E.g., Midamerica Mutual Fund, Inc.*, 41 S.E.C. 328 (1963); *Investors Diversified Services, Inc.*, Inv. Co. Act Rel. No. 3015 (1960), F.Sec. L. Rep. ¶ 76,699; *Variable Annuity Life Insurance Co.*, Inv. Co. Act Rel. Nos. 2974 and 2975 (1960), F.Sec. L. Rep. ¶ 76,688; see *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 (1972) (no standing); *cf. First Multifund of America, Inc.*, Inv. Co. Act Rel. No. 6700 (1971), F.Sec. L. Rep. ¶ 78,209 at p. 80,603 n.13.

[258] Inv. Co. Act Rel. No. 8570 (1974), F. Sec. L. Rep. ¶ 79,998.

SEC promulgated rule 22c-1,[259] which replaced NASD-sanctioned twice-daily, backward pricing with once-daily, forward pricing for fund shares.[260]

4. *The SEC's Current Mutual Fund Program*

The SEC's many years of regulatory control over mutual fund distribution have recently culminated in (1) its staff's 375-page study on the potential impact of a repeal of Section 22(d), released in 1972, (2) its two months' of hearings on mutual fund distribution in 1973, and finally, (3) its 135-page 1974 Mutual Fund Report and implementing letter to the NASD. This 1974 Report embodies the Commission's comprehensive "program" for the mutual fund industry in the future. The SEC contemplates the full exercise of "existing administrative powers to lay the groundwork for the *gradual and orderly* introduction of retail price competition into the mutual fund distribution system."[261]

With respect to purported restrictions on contract dealers engaging in brokered sales between investors, the SEC has decided to experiment with only limited "genuine matching."[262] The Commission has asked the NASD to issue a rule removing contract restrictions on such "matching" and has indicated a willingness to use the SEC's Section 22(f) power to ensure such a result.[263] The SEC apparently hopes that such

[259] 17 C.F.R. § 270.22c-1.

[260] Inv. Co. Act Rel. No. 5519 (1968), F.Sec. L. Rep. ¶ 77,616.

[261] 1974 Mutual Fund Report at v (emphasis added).

[262] Garrett letter, Add. 18-19.

[263] *Id.*

limited "matching" will not contradict the basic purposes of Section 22(d)—protection of the primary market distribution system and prevention of unjust discrimination.[264] Nevertheless, the Commission acknowledges that "it is difficult to predict the actual impact of a limited secondary brokered market for fund shares"[265] and expressly reserves the SEC's prerogative to reverse the policy change if it proves mistaken.

The SEC suggests several regulatory steps "to help neutralize any adverse impact upon the funds' primary distribution systems, and to ensure that transactions in a brokered market do not injure existing shareholders."[266] By public releases and by regulations under Section 22(f), the SEC will decide how large a transfer fee (covering both recording costs and lost underwriter revenue) may be imposed upon a brokered "match." By an interpretative rule under Section 38(a) to "safeguard against the secondary brokered market functioning like a dealer market," the SEC will prevent the inventorying of potential "match" orders and will limit the brokered market to essentially contemporaneous and fortuitous "matching."[267] By a Section 22(f) rule, a Section 6(c) exemption, or Commission supervision of the NASD rulemaking and enforcement process, the SEC will permit a "fund to restrict the transferability of its shares so as to prevent their sale in a secondary brokered market if the fund c[an] show that such a

[264] See pages 61-64, *supra*.

[265] 1974 Mutual Fund Report at 105.

[266] *Id.*

[267] *Id.* at 107.

market in its shares ha[s] become so extensive and price-competitive as to present a significant threat to the fund's primary distribution system."[268] Finally, the SEC will not require brokers to set up "special procedures" to match orders[269] and will make participation in a secondary brokered market "optional for brokers."[270]

Although fully apprised of the allegations in this case[271] and having transmitted a letter from its general counsel to the court below,[272] the SEC recommends no policy change with respect to distribution agreements which allegedly restrict or inhibit contract dealers' participation in the secondary inter-dealer market. It does not propose rules or regulations under Section 22(f) to prohibit any inter-dealer restrictions in presently registered distribution agreements. Nor is it asking the NASD to change its rules in this respect. Indeed, the Commission explicitly rejects, for the present, any thought of "establishing a secondary dealer market."[273]

B. The SEC Has Full Regulatory Authority Over the Conduct at Issue

This case turns primarily on the distribution agreements used by the appellee funds and other funds

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[268] *Id.* at 108.

[269] Garrett letter, Add. 19; Inv. Co. Act Rel. No. 8570 at 5 (1974) F. Sec. L. Rep. ¶79,998 at p. 84,577.

[270] Inv. Co. Act Rel. No. 8570 at 6, F. Sec. L. Rep. ¶ 79,998 at p. 84,577.

[271] 1974 Mutual Fund Report at 104 *et seq.*

[272] J. App. 323.

[273] 1974 Mutual Fund Report at vii.

in the industry. These agreements, and all of their terms and conditions, were never a secret at the SEC.[274] Even before the passage of the Investment Company Act in 1940, the agreements were well known to the SEC because of their inclusion in the securities registration statements filed under the 1933 Act[275] and their discussion in the Investment Trust Study.[276] Since 1940 these agreements and amendments thereto have been a required part of the funds' 1940 Act registration statements and the funds' quarterly and annual reports under both Acts.[277] The SEC has known (1) that NASD Rule 26(c) required dealers to sign agreements with underwriters before they could sell a single mutual fund share in the primary market, (2) that underwriters were compelling dealers to sign the particular restrictive agreements disclosed in filings at the SEC, and (3) that the allegedly restrictive language complained of in this case was included in such agreements.[278]

From the time it approved Rule 26(c) in 1941 to the present, the SEC has always known that it could revoke its approval of Rule 26(c) and promulgate a superseding rule.[279] The SEC has also known that it

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[274] Compare *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213 (1966).

[275] See page 92-93, *supra*.

[276] See page 29-30, *supra*.

[277] See page 91-92, *supra*.

[278] See page 38, *supra*.

[279] In fact, that is what happened to original NASD Rule 26(e), which was superseded by SEC Rule 22c-1, 17 C.F.R. § 270.22c-1, in 1969 after twenty-eight years. See page 96, note 237, *supra*. Alternatively, the SEC long ago could have done what it has only re-

could use Section 22(f) and its other powers to prohibit transferability restrictions imposed by contract or rule.[280] Quite consciously, the SEC until now[281] has chosen *not* to change Rule 26(c) and *not* to adopt Section 22(f) rules or regulations prohibiting or narrowing the restrictions contained in the registered distribution agreements. After all these years, it would elevate form over substance to conclude that the SEC has not—as part of its duly authorized regulatory function—approved these agreements and intended that they govern relationships in the mutual fund distribution field.

The situation with respect to these agreements is totally different from that in *Silver* v. *New York Exchange,* 373 U.S. 341 (1963), where the SEC clearly *lacked jurisdiction* to approve the conduct at issue, a particular application of stock exchange disciplinary rules. *Id.* at 357-58. The *Silver* opinion itself stated that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, *supra.*" *Id.* at 360. Note 12 described one such "different case," namely SEC review of NASD self-regulation under the Maloney Act. *Id.* at 358 n.12. In our case, the SEC's full scope of authority over publicly filed distribution agreements and its detailed regulatory control over so many aspects of mutual fund sales, pricing, investor information, and related NASD activity makes

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cently done, *i.e.,* request the NASD itself to change Rule 26(c). See Garrett letter, Add. 18.

[280] See page 35, note 73, *supra.*

[281] See 1974 Mutual Fund Report at 105, 105 n. 1.

this, too, the "different case" recognized in *Silver.* In the circumstances of this "different case," the SEC, not the antitrust court, has exclusive jurisdiction to balance competitive considerations with the many other public interest considerations embodied in the Investment Company Act and other federal securities laws.

This conclusion cannot be any different with respect to the unfounded allegations in appellant's complaint concerning a purported "combination" or "conspiracy" between the NASD and its members. (Count I, ¶ 17.) These allegations relate to matters fully within the SEC's exclusive regulatory authority; and, consequently, the antitrust laws should not interfere.[282] The overworked 1959 incident (J.B. 61) is actually typical of the continual SEC-NASD-NASD membership dialogue which has been the accepted pattern of cooperative regulation for many years.[283] An NASD letter (GX 18, J. App. 278) advised members that distribution agreements might be amended to prevent contract dealers from taking down shares for resale to non-contract dealers. Far from being a bad faith bypass of SEC procedures, as appellant implies (J.B. 61), the NASD letter actually relayed to NASD members *the SEC staff's view* that the agreements could and often did bar such transactions (see GX 6, J. App. 251-52) and the *SEC staff's suggestion* that investment company underwriters might amend their agreements to cover the point involved, if they had

[282] The appellant has conceded this, in great part, by abandoning the key portions of Count I—its attack on NASD rules (¶¶ 17(a) & 17 (b) and ¶ 6 of the prayer for relief). See pages 19-20, *supra*.

[283] See Hed-Hoffman, "The Maloney Act Experiment," 6 B.C. Ind. & Comm. L.Rev. 187, 211 (1965).

not already done so. (See GX 16, J. App. 274.) The SEC staff's advice was fully consistent with that agency's continuing power, particularly under Section 22(f), to regulate transferability restrictions in publicly filed distribution agreements.[284]

Appellant's allegations about NASD dissemination of misleading market information and suppression of market quotations similarly fail to recognize the SEC's exclusive authority over these subjects. The SEC keeps close watch on the current availability and nature of such material. It has ample power to correct any misimpressions or confusion and to conform market practices to the purposes of the Investment Company Act. Market information is totally regulated by the SEC, directly and through its control of NASD rules and bylaws.[285]

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[284] Unlike *Georgia* v. *Pennsylvania R.R.*, 324 U.S. 439 (1945), any changes in the agreement restrictions, whether or not the product of collective action, would be apparent to the SEC, in any event, through public filings of the sales agreements and the amendments thereto. The market impact of such changes would always be fully within the control of the SEC under Section 22(f). Furthermore, that doctrine which permits private parties to join together to influence a government agency without risking antitrust liability (see *United Mine Workers* v. *Pennington*, 381 U.S. 657, 670 (1965)), surely authorizes their Congressionally sanctioned self-regulatory association to communicate to them the agency's response and to suggest an open and public course of action which will be fully subject to the agency's continuing scrutiny.

[285] Article XVI of the NASD's bylaws governs member-dealers' computerized over-the-counter communications network (NASDAQ), and, as with all NASD bylaws, cannot be altered without SEC approval. Section 15A(b)(12) of the 1934 Act, as added in 1964, 15 U.S.C. § 78o-3(b)(12), requires the NASD to issue rules, subject to the usual vigorous SEC scrutiny, governing the form, content, manner of dissemination, and recipients of market quotations. See, *e.g.*, NASD Rules of Fair Practice, Art. III, §§ 5-6. Investors' information continues to be channeled through prospec-

C. Antitrust Immunity Necessarily Arises Here Because the Pervasive Regulatory Control of the Conduct Alleged Is in Irreconcilable Conflict with the Antitrust Laws.

In granting the SEC its pervasive authority over the conduct in issue, Congress necessarily intended to displace the antitrust laws in this unique area. Analogous decisions by this Court and other precedents in the securities area show that the appellees' conduct should be impliedly immune from antitrust challenge and confined to the SEC's exclusive jurisdiction.

In *Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296 (1963), the government charged under the Sherman Act that Pan American, an air carrier, and W. R. Grace, a common carrier, had unlawfully agreed upon a division of South American routes between their jointly owned airline, Panagra, and Pan American itself. The government further alleged that Pan American had unlawfully used its 50% control of Panagra to prevent the latter from securing Civil Aeronautics Board ("CAB") authority to operate from the Canal Zone to the United States. This Court held that the complaint should have been dismissed because the CAB had exclusive jurisdiction of the conduct alleged.

The Court's findings in *Pan American* bear a striking resemblance to the facts of the case at bar, despite the expected dissimilarities between the airline and mutual fund industries. In *Pan American* the Court found that the Federal Aviation Act and its predecessor Civil Aeronautics Act were a legisla-

tuses and other sales literature, all of which must be filed with the SEC and must comply with SEC disclosure guidelines on topics such as markets for shares and pricing. See page 92, *supra*.

tive reaction to destructive competition, 371 U.S. at 301, and that they were intended to create "a regime designed to change the prior competitive system." *Id.* The CAB was cast in the role of producing "the proper degree of 'competition'" by means of regulation. Similarly, Sections 22(d) and 22(f) of the Investment Company Act are, among other things, a reaction to the destructive competition caused prior to 1940 by a secondary market in mutual fund shares.

Just as the CAB "is empowered to deal with numerous aspects of what are normally thought of as antitrust problems," *id.* at 305, so the SEC has authority, *inter alia,* to enforce the fixed-price mandate of Section 22(d) in both primary and secondary markets, to permit certain variations in fixed prices, to control methods of calculating prices, to regulate the sales load and net asset value components of prices, to regulate the activities of the NASD, to disapprove under Section 22(f) restrictions on transferability disclosed through registration statements, and to control the quality and quantity of market information available to investors. Indeed, the appellant's goal of lower sales charges for investors,[286] is a subject already entrusted to the exclusive regulatory control of the NASD and the SEC under Sections 22(b) and (c) of the Investment Company Act, as amended in 1970. Under that law, the sales loads may not be so high as to be "excessive" and not "reasonable" for investors, but the loads also may not be so low as to fail to "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters * * *." 15 U.S.C. § 80a-22(b)(1).

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[286] Complaint ¶ 59(b), J. App. 17.

Just as the CAB in *Pan American* possessed the authority to protect the public interest in its continuing review, *id.* at 305, so the SEC has the authority to accept, suspend, or revoke the registrations of mutual funds, their underwriters, and dealers, and their industry association. Just as the "public interest" standard of the Aviation Act requires the CAB to consider "unfair methods of competition" and weigh considerations of "competition and monopoly," *id.* at 306-07, 309, so the SEC must and does weigh antitrust concerns along with other public interest considerations required by the law it administers.[287]

In *Pan American,* territorial divisions, route restrictions, and carrier affiliations, were said to be "basic in this regulatory scheme." *Id.* at 305. Similarly, mandatory resale price-fixing, restrictive distribution contracts, and self-regulation through an industry-wide organization, are "basic" to the Investment Company Act-Maloney Act scheme of mutual fund distribution. Whereas in *Pan American* the Court ruled that the acts charged were "precise ingredients" of the CAB's continuing authority, *id.* at 305, so here the District Court found that the acts alleged are precise ingredients of the SEC's continuing authority over mutual funds. Under both airline and mutual fund regulatory systems, "where the problem lies within the purview of the [federal agency] * * *, Congress must have intended to give it authority that was ample to deal with the evil at hand." *Id.* at 312. In each instance, "[i]f the courts

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[287] See page 95, footnote 233, *supra; cf. **Federal Maritime Commission*** v. ***Aktiebolaget Svenska Amerika Linien,*** 390 U.S. 238, 244 (1968); ***Hawaiian Telephone Co.*** v. ***Federal Communications Commission,*** 498 F.2d 771 (D.C. Cir. 1974).

were to intrude independently with their construction of the antitrust laws, two regimes might collide." *Id.* at 310.[288]

Hughes Tool Co. v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973), relied heavily on the *Pan American* decision. The crux of TWA's antitrust complaint there was the use by Hughes Tool of its ownership of TWA to dictate the manner by which TWA acquired and financed aircraft. The Court held that the challenged actions of TWA's parent were under the continuing "control and surveillance" of the CAB and accordingly were shielded from antitrust attack. *Id.* at 366. The CAB had approved Hughes Tool's acquisition of control over TWA and retained the power "to investigate and alter the manner in which that 'control' is exercised * * *." *Id.* at 385. The CAB's order approving control "did not sanction the precise way" in which that control was later exercised. *Id.* at 379. Nonetheless, the important factor, in the Court's view, was that the alleged "conduct was *within the power* of the Board to control and was central to [its] mandate * * *." *Id.* at 389 (emphasis added). Competitive considerations were "in the mainstream" of the Board's responsibilities to the public interest. *Id.* at 382.

As the *Hughes Tool* decision pointedly observed, the *Pan American* case had immunized conduct al-

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[288] In *Pan American,* one statutory provision clearly relieved persons complying with certain CAB orders from antitrust liability. *Id.* at 304. At least four statutory provisions in the case at bar, Sections 22(d), 22(f), and 22(b)(4) of the Investment Company Act, and Section 15A(n) of the Maloney Act amendment to the 1934 Act, explicitly or necessarily exempt practices from antitrust challenge.

legedly violative of the antitrust laws "even though the CAB had taken no action to investigate, let alone act on, the alleged misfeasance as the Board has done here for over 16 years." *Id.* at 386. In the present case, the record of agency action is even greater than in *Hughes Tool.* For thirty-five years the SEC has been controlling the pricing and sale of mutual fund shares, receiving copies of the allegedly restrictive distribution agreements, studying their effect, refusing to regulate against them, and reporting on the intended non-existence of price-competitive secondary markets. Indeed, over the last thirteen years, the SEC has published five separate studies of mutual fund distribution problems, the most recent of which is its 1974 Report. The SEC has left no doubt that the crucial issues of this case are, in the words of *Hughes Tool,* "within [the SEC's] power" and "central to [its] mandate."

The only case prior to this to consider an antitrust claim in an Investment Company Act context was *Baum* v. *Investors Diversified Services, Inc.,* 286 F. Supp. 914 (N.D. Ill. 1968), aff'd on other grounds, 409 F.2d 872 (7th Cir. 1969). After an extensive review of that Act, the district court found that the SEC has "pervasive regulatory power over [mutual fund] commission rates" and held that sales load discounts are "governed exclusively by the SEC under the Investment Company Act * * *." *Id.* at 926, 927. Consequently, a particular fund's grant of quantity discounts, being clearly subject to the SEC's rule-making power, was held to be impliedly immune from challenge under the Robinson-Patman Act, 15 U.S.C. § 13(a).

The most recent appellate decision finding implied antitrust immunity in the securities context was *Gordon* v. *New York Stock Exchange, Inc.,* 498 F.2d 1303 (2d Cir.), cert. granted, 43 U.S.L.W. 3290 (U.S. Nov. 18, 1974). The U.S. Court of Appeals for the Second Circuit held that Section 19(b) of the 1934 Act, 15 U.S.C. § 78s(b), vests the SEC with exclusive jurisdiction to determine to what extent the continued fixing of stock exchange commission rates is necessary and proper, and thereby displaces separate antitrust jurisdiction. The *Gordon* court was plainly impressed with "the wide-reaching and systematic character of recent SEC action regarding rate regulation * * *." *Id.* at 1308. Concluding that frustration of the SEC-supervised, self-regulatory aims of the 1934 Act "would be the inevitable consequence of duplicative or inconsistent standards announced contemporaneously by courts and Commission," *id.* at 1306, the court implied an antitrust immunity even though the statute contained no express exemption.[289]

On the basis of *Gordon,* the instant appeal is an *a fortiori* case for implied antitrust immunity because Section 22 of the Investment Company Act clearly commands and contemplates conduct which is inconsistent with strict antitrust standards. Indeed, here, Congress has written several express antitrust exemp-

[289] Accord, *Kaplan* v. *Lehman Bros.,* 371 F.2d 409 (7th Cir. 1967), cert. denied, 389 U.S. 954 (1967); *Stark* v. *New York Stock Exchange, Inc.,* 466 F.2d 743 (2d Cir. 1972); but see *Thill Securities Corp.* v. *New York Stock Exchange, Inc.,* 433 F.2d 264 (7th Cir. 1970), cert. denied, 401 U.S. 994 (1971); but *cf. Harwell* v. *Growth Programs, Inc.,* 451 F.2d 240 (5th Cir. 1971), rehearing denied, 459 F.2d 461, cert. denied *sub. nom., Nat'l Ass'n of Securities Dealers, Inc.* v. *Harwell,* 409 U.S. 876 (1972).

tions into the applicable statutes.[290] There is abundant evidence in this case that the Congressionally mandated, fixed-price structure of load fund distribution is "the keystone" in preserving the viability of the present system for continuously selling redeemable fund securities. See *Gordon, supra,* 498 F.2d at 1307. The SEC, with Congressional direction, is the proper agency to modulate the amount of competitive pressure and investor discrimination that this system can tolerate.

The present case is a classic illustration of how the subjection of pervasively regulated "conduct to antitrust liability would create a basic conflict with the authority of the regulatory agency" (J.B. 56). Generally, perhaps, a "regulatory scheme and the antitrust laws are presumed to be complementary, not conflicting" (J.B. 57-8); but that presumption is categorically rebutted by the regulatory facts of this case.

Since at least 1940, Congress has viewed mutual fund distribution as a special type of underwriting and has considered underwriting as a field where many of the usual antitrust strictures are not to be applied.[291] Had Congress intended the application of the antitrust laws here, it would not have sanctioned, through Section 22(f), the continuation of publicly disclosed restrictions on share transferability. Nor would Congress in Section 22(b)(1) have authorized

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[290] See page 112, footnote 288, *supra*.

[291] See 1967 House Hearings, *supra*, at 59; *cf. United States* v. *Morgan*, 118 F. Supp. 621, 690 (S.D.N.Y. 1953).

competitors to combine through the NASD to engage in a type of cooperative ratemaking, *i.e.,* the regulation of sales loads on both the high and the low sides. Nor would Congress have granted the SEC far-reaching authority to control transferability restrictions through regulation, to grant exemptions from strict price-fixing, and to closely review and, if warranted, supersede NASD sales load rules. If Congress had intended no conflict between the antitrust laws and mutual fund regulation, it would not have imposed nationwide price maintenance on funds, underwriters, contracting dealers, and non-contracting dealers alike, through Section 22(d), nor provided severe criminal sanctions for price-cutting. In 1970, if Congress had wanted to reinstitute price competition between primary and secondary markets for mutual fund shares, it would not have reenacted Section 22(d).

The unique aspects of the load mutual fund industry—continuous offerings, compulsory redemption and the concomitant potential for self-liquidation, mandatory price maintenance in all public sales, determination of the principal price component of shares (net asset value) by supply and demand for the fund's portfolio assets, and close regulation of the sales load price component by both the NASD and the SEC—all are reasons why the Commission should exclusively control the conduct at issue here. It was because of these unique mutual fund characteristics that Congress never intended any "free and open market", in the traditional sense, for load mutual

fund shares.[292] The SEC's present regulatory program for mutual funds recognizes this intent; the appellant's suit clearly does not.

The appellant's prayer for relief herein is in plain conflict with many aspects of the SEC's carefully defined program.[293] For instance, appellant seeks to establish a broad and uninhibited "brokerage market" rather than the SEC's limited "genuine matching" market in which inventorying of orders would be prohibited and the implementation of "special procedures" would not be required. Whereas the SEC program contemplates the approval from time to time of certain restrictions on "matching," the appellant requests a perpetual injunction against all such restrictions without regard to the effect a brokerage market may have upon a fund's primary distribution system.

In short, there is a clear conflict between the SEC's exercise of "quasi-legislative" policy-making "for the gradual and orderly introduction of retail price competition into the mutual fund distribution system", 1974 Mutual Fund Report at v, and the appellant's blunderbuss approach. If the SEC is not to be hampered and circumscribed in the exercise of its regulatory authority under the Investment Company Act, the conduct at issue in this case should be reserved for exclusive SEC jurisdiction. Antitrust

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[292] *Accord, Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.*, 9 S.E.C. 38, 46 (1941).

[293] See pages 102-04, *supra*, for the detailed description of that program.

courts, operating with isolated case-and-controversy records, are ill-equipped to render the sort of policy judgments in the mutual fund area which the SEC is regularly and expertly making.[294] In contrast to the SEC's "quasi-legislative" function, "the [courts'] judicial function is traditionally to weigh the merits of particular controversies, but not to engage in a consistent determination of policy or to maintain steady contact with a general and continuing problem."[295] Unlike the SEC, antitrust courts are not equipped to host industry-wide hearings, or to assess the interrelationship of a particular practice to the structure of the total industry, or to anticipate the implications of a modification or abandonment of such a practice.[296] By way of contrast, as the SEC stated in its transmittal of the 1974 Mutual Fund Report to Congress:

> It is the genius of the administrative process that the intent of Congress can be effectuated in a complex and specialized area by an agency

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[294] *Cf. Port of Boston Marine Terminal Ass'n.* v. *Rederiaktiebolaget Transatlantic,* 400 U.S. 62, 69 (1970).

[295] W. Gellhorn "The Administrative Agency—A Threat to Democracy?" in *Separation of Powers and the Independent Agencies: Cases and Selected Readings,* S. Doc. No. 91-49, 91st Cong., 1st Sess. at 517 (1970).

[296] With respect to price-fixing, for instance, this Court's announcement of the *per se* illegality rule in *United States* v. *Trenton Potteries Co.,* 273 U.S. 392, 397-98, (1927), was premised on the judiciary's inability to assess the reasonableness of particular types of price-fixing in different economic settings. Not surprisingly, even Congress has expressed reluctance to change the Congressionally imposed system of mutual fund price-fixing without receiving further comprehensive studies and recommendations from the SEC.

which is provided with flexibility and discretion to adjust the law as circumstances demand. [*Id.* at viii.]

In sum, if the Congressional scheme in this complex and specialized area is to "work", *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 357, the SEC must be permitted to experiment with competition and to implement it step-by-step without *ad hoc* judgments or second-guessing by antitrust courts.[297] Balancing of all aspects of the public interest "becomes far too hazardous with two hands on the tiller * * *."[298]

CONCLUSION

The instant action is unfounded because:

(1) The challenged distribution agreements have been publicly filed in SEC registration statements for at least 35 years.

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[297] In light of the SEC's statement on the record in the District Court, its public addresses and releases, and, most importantly, its 1974 Report, there should be no doubt that the SEC views the instant controversy as within its exclusive jurisdiction. Should there be any question about the SEC's views, the Court could still remand the matter to the District Court for a primary jurisdiction referral to the SEC. The agency could then consider, on the basis of a formal record, why exclusive SEC jurisdiction is necessary to enable the regulatory scheme to work. See *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289 (1973); *Chicago Mercantile Exchange* v. *Deaktor,* 414 U.S. 113 (1973). When the District Court noted that "the cases at bar do not involve the doctrine of primary jurisdiction" (J. App. 361 n.59), this indicated acceptance of the defendants' argument that the motions to dismiss could be decided by the court on exclusive jurisdiction grounds without reaching the primary jurisdiction question.

[298] *Gordon* v. *New York Stock Exchange, supra,* 498 F.2d at 1308.

(2) The restrictions in the contracts attacked as "per se illegal" are expressly sanctioned by Section 22(f) of the Act unless and until the SEC disapproves them.

(3) Prior to the District Court's decision, appellant abandoned its attack on the SEC-approved Rules of the NASD which regulate mutual fund distribution and require the use of the publicly filed agreements challenged here.

(4) The complaint seeks to require an unregulated secondary brokerage market which is contrary to the clear intent of Congress in enacting Section 22(d) to prevent the kind of price competition from a secondary market as existed in 1940 when the Act was passed. This Congressional intent was re-affirmed in 1970 when Congress re-enacted Section 22(d) in full with the unmistakable understanding that, by so doing, it was forbidding any form of intra-brand price competition in the mutual fund distribution system.

(5) Appellant has charged dealers with failure to utilize an alleged loophole in Section 22(d), even though such action might be criminal, would contravene the purposes of Section 22(d), and if carried over to other provisions of the federal securities laws, would invite a wholesale effort to evade these laws and the jurisdiction of the SEC.

(6) Appellees are thus placed between Scylla and Charybdis, forced to choose between violations of the securities laws or the antitrust laws, both of which are criminal acts.

(7) At virtually the same time that it filed this case, appellant was inconsistently urging the SEC to exercise its broad rulemaking and exemptive powers under Section 6(c) and 22(f) of the Act to accomplish much the same results.

(8) Notwithstanding appellant's efforts to derogate from the SEC's jurisdiction, the SEC continues its close regulation of the industry and is proposing to implement some of appellant's suggestions, subject to necessary safeguards and reappraisal.

(9) The SEC's chosen instrument for effecting these changes is the appellee NASD, whose self-regulatory activities are under attack in this case.

In sum, an industry whose sales and pricing practices have been minutely regulated and publicly disclosed, suddenly finds itself before the federal courts charged with "per se" violations of the antitrust laws for doing that which was sanctioned and required by federal statutes and regulations.

This entire complaint could and should have been directed to the SEC. Not only could the relief which appellant seeks be obtained from the SEC, but ironically, a major portion of that relief will soon be ordered by the SEC. If appellant remains unsatisfied with SEC regulation of the industry, its recourse is to Congress, not to the courts.

The judgment of the District Court should be affirmed.

Respectfully submitted,

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ADDENDUM

ADDENDUM

Pertinent Provisions of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, et. seq.

Section 2(a)(11), 15 U.S.C. § 80a-2(a)(11) provides:

(11) "Dealer" means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

Section 2(a)(34), 15 U.S.C. § 80a-2(a)(34) provides:

(34) "Sale", "sell", "offer to sell", or "offer for sale" includes every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been sold for value.

Section 6(c), 15 U.S.C. § 80a-6(c) provides:

(c) The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.

Section 15(b), 15 U.S.C. § 80a-15(b) provides:

(b) It shall be unlawful for any principal underwriter for a registered open-end company to offer for

sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment.

Section 22, 15 U.S.C. § 80a-22 provides:

(a) A securities association registered under section 78o-3 of this title may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing as far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or

surrendering for redemption any such redeemable securities in contravention of said rules.

(b)(1) Such a securities association may also, by rules adopted and in effect in accordance with section 78*o*-3 of this title, and notwithstanding the provisions of subsection (b)(8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its members from purchasing, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operating costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(2) At any time after the expiration of eighteen months from December 14, 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 78*o*(b)(10) of this title as are appropriate to effectuate the purpose of this section with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 78*o*(b)(8) of this title: *Provided*, That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed

that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(3) At any time after the expiration of eighteen months from December 14, 1970 (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule respecting excessive sales loads), the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 78*o*-3(k)(2) of this title.

(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail.

(c) The Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any securities association, to the same extent, covering the same subject matter, and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members. Any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price

described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 80a-11 of this title; (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 80a-12 of this title.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except

(1) for any period (A) which the New York Stock Exchange is closed other than customary week-end and holiday closing or (B) during which trading on the New York Stock Exchange is restricted:

(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection. Any company which, as of March 15, 1940, was required by provision of its charter, certificate or incorporation, articles of association, or trust indenture, or of a bylaw or regulation duly adopted thereunder, to

postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this subchapter, or upon the repeal or amendment of such provision, or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Section 38(a), 15 U.S.C. § 80a-37(a) provides:

(a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this subchapter, including rules and regulations defining accounting, technical, and trade terms used in this subchapter, and prescribing the form or forms in which information required in registration statements, applications, and reports to the Commission shall be set forth. For the purposes of its rules or regulations the Commission may classify persons, securities, and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities, or matters.

Section 38(c), 15 U.S.C. § 80a-37(c) provides:

(c) No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, by amended or rescinded or be determined by

judicial or other authority to be invalid for any reason.

Section 48(a), 15 U.S.C. § 80a-47(a) provides:

(a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter or any rule, regulation, or order thereunder.

Section 49, 15 U.S.C. § 80a-48 provides:

Any person who willfully violates any provision of this subchapter or of any rule, regulation, or order hereunder, or any person who willfully in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter or the keeping of which is required pursuant to section 80a-30 (a) of this title makes any untrue statement of a material fact or omits to state any material fact necessary in order to prevent the statements made therein from being materially misleading in the light of the circumstances under which they were made, shall upon conviction be fined not more than $10,000 or imprisoned not more than two years, or both; but no person shall be convicted under this section for the violation of any rule, regulation, or order if he proves that he had no actual knowledge of such rule, regulation, or order.

Pertinent Provisions of the Maloney Act of 1938, As Amended, 15 U.S.C. § 78o-3

15 U.S.C. § 78o-3(b) provides:

An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this chapter and the rules and regulations thereunder and to carry out the the purposes of this section.

(2) such association is so organized and is of such a character as to be able to comply with the provisions of this chapter and the rules and regulations thereunder, and to carry out the purposes of this section.

(3) the rules of the association provide that any broker or dealer who makes use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (4) or (5) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to or refuse to continue in such association any broker or dealer if—

(A) such broker or dealer, whether prior or subsequent to becoming such, or

(B) any person associated with such broker or dealer, whether prior or subsequent to becoming so associated,

has been and is suspended or expelled from a national securities exchange or has been and is barred or suspended from being associated with all members of such exchange, for violation of any rule of such exchange.

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if such broker or dealer—

(A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange or has been and is barred or suspended from being associated with all members of such association or from being associated with all brokers or dealers which are members of such exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade.

(B) is subject to an order of the Commission denying, suspending for a period not exceeding twelve months, or revoking his registration pursuant to section 78*o* of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or barring or suspending him from being associated with a broker or dealer.

(C) whether prior or subsequent to becoming a broker or dealer, by his conduct while associated with a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such broker or dealer, and in en-

tering such a suspension, expulsion, or order, the Commission or any such exchange or association shall have jurisdiction to determine whether or not any person was a cause thereof.

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who, if such person were a broker or dealer, would be ineligible for admission to our continuance in membership under clause (A), (B), or (C) of this paragraph.

(5) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such member. For the purpose of defining such standards and the application thereof, such rules may—

(A) appropriately classify prospective members (taking into account relevant matters, including type of business done and nature of securities sold) and persons proposed to be associated with members.

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members)

of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association may adopt procedures for verification of qualifications of the applicant.

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (a) of section 78ff of this title, be deemed an application required to be filed under this chapter).

(6) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

(7) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

(8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issues, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to

impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

(9) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

(10) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and persons associated with members and the denial of membership to any broker or dealer seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include—

(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted.

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

(D) a statement setting forth the penalty imposed.

In any proceeding to determine whether a broker or dealer shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the broker or

dealer or person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based.

(11) the requirements of subsection (c) of this section, insofar as these may be applicable, are satisfied.

(12) the rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be disseminated by any member or any person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations. The provisions of this subsection, as in effect prior to August 20, 1964, shall be applicable to the rules of any registered securities association which was registered on such date until July 1, 1964. After July 1, 1964, the Commission may, after notice and opportunity for hearing, suspend the registration of any such association if it finds that the rules thereof do not conform to the requirements of this subsection, as amended by section 7 of the Securities Act Amendments of 1964, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

15 U.S.C. § 78o-3(j) provides:

Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission

may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a) of this section. Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsections (b) and (d) of this section.

15 U.S.C. § 78o-3(k) provides:

(1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purpose of this chapter.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested, or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to—

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with

members, or the qualifications required for members or natural persons associated with members or any class thereof.

(B) the method for adoption of any change in or addition to the rules of the association.

(C) the method of choosing officers and directors.

(D) affiliation between registered securities associations.

15 U.S.C. § 78o-3(n) provides:

If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provisions of this section shall prevail.

S.3580, 76th Cong., 3rd Sess. § 22 (Introduced March 14, 1940)
(Proposed by SEC) (Not Enacted)

SEC. 22. (a) No registered investment company or principal underwriter therefor shall sell, redeem, or repurchase any redeemable security of which such a company is the issuer, except at a price bearing such relation to the current asset value of such security, computed as of such time, as the Commission shall prescribe by rules and regulations or orders, for the purpose of eliminating or reducing to a practical minimum any dilution of or accretion to the current asset value of any other securities of such company as a consequence of such sale, redemption, or repurchase.

(b) No underwriter or dealer, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, shall purchase any such security from the issuer or from any underwriter except at the price at which he sells such security, less a commission or spread allowed him by the person selling to him.

(c) If at any time the Commission has reason to believe that any redeemable security is being offered for sale or sold to the public by the issuer or any underwriter at a price which includes an unconscionable or grossly excessive sales load, the Commission shall cause to be served upon the issuer (or if the issuer is a unit investment trust, upon its depositor), and upon every principal underwriter for the issuer, a notice to appear and show cause why such sales load should not be prohibited. If, after hearing the evidence, the Commission finds that the issuer or any principal underwriter therefor is selling such securities to the public at a price including an unconscionable or grossly excessive sales load, the Commission shall order such company, underwriter, or underwriters, as the case may be, to cease and desist from selling at such price. In determining whether a sales load is unconscionable or grossly excessive, due weight shall be given to the incidents, denominations, and selling

price of the securities involved, to the organization, investment policy, past and prospective earnings, management expenses, and management and sales methods of the issuer, its managers, depositors, underwriters, and dealers and its and their competitors, and to such other factors as are relevant in the particular proceeding.

(d) The Commission is authorized, by rules and regulations or order in the public interest or for the protection of investors, to prohibit—

(1) the suspension, in whole or in part, of the redemption privileges of any redeemable security of which any registered investment company is the issuer; and

(2) restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.

Add. 18

Letter, Ray Garrett, Jr., SEC Chairman

to

Gordon Macklin, President, National Association of Securities Dealers, Inc.
November 22, 1974

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

November 22, 1974

Mr. Gordon S. Macklin
President
National Association of
Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Macklin:

On November 4, 1974, the Commission transmitted to Senator John Sparkman, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, a staff report entitled "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940" ("Staff Report").

That report, among other things, recommended that the Commission request the NASD to amend its Rules of Fair Practice to prohibit its members from being parties to agreements which restrict broker-dealers, acting as agents, from matching orders to buy and sell fund shares in a secondary market at competitively determined prices and commission rates.

The Commission has considered that recommendation and, although the Rules of Fair Practice do not require that agreements between fund underwriters and broker-dealers contain such restrictions, it believes that sound regulatory policy dictates the elimination of any such

restrictions. As the staff's report suggests, however, action in this area should also include steps to help to neutralize any adverse impact on the funds' primary distribution systems and to ensure that transactions in a brokered market are in the interest of all of the holders of the funds' outstanding shares. For example, funds would be permitted to impose reasonable service fees when ownership of their shares is transferred in this manner. In the absence of any underwriters' spread on the sale, such fees could include the cost of recording the transfer as well as an amount to compensate the underwriter, to some extent, for promotional services. To ensure that broker-dealers engage only in the genuine matching of orders, they should not be permitted to fill orders to buy or sell fund shares more than one full business day after such orders are received. Nor should broker-dealers be required to set up special procedures to match orders for fund shares.

Accordingly, in order to implement the foregoing, we ask your assistance and request the NASD to amend its Rules of Fair Practice as suggested above and as outlined in detail in the Staff Report.

Sincerely,

/s/ Ray Garrett, Jr.
RAY GARRETT, JR.
Chairman

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[illegible]

[illegible]

40, 41 [illegible]

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39 [illegible]

[illegible]

38 [illegible]

40, 41, 42, 44 [illegible]

In the Supreme Court of the United States

October Term, 1974

No. 73-1701

United States of America, appellant

v.

National Association of Securities Dealers, Inc., et al.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINION BELOW

The opinion of the district court (J.S. App. A, 29-68), accompanying its order of dismissal (J.S. App. B, 69-70), is reported at 374 F. Supp. 95.

JURISDICTION

The memorandum opinion and order of the district court were entered on December 14, 1973. The notice of appeal to this Court (J.S. App. C, 71) was filed on February 11, 1974. On March 14, 1974, the Chief Justice extended the time for docketing the appeal to May 13, 1974, and the appeal was docketed on that

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date. Probable jurisdiction was noted on October 15, 1974. The jurisdiction of this Court is conferred by Section 2 of the Expediting Act, 15 U.S.C. 29.

QUESTION PRESENTED

This case involves several unique characteristics of mutual funds which underlie the scheme of regulation of the distribution and marketing of mutual fund shares contained in Section 22 of the Investment Company Act. These include the following: [1]

1. Mutual funds stand ready to redeem their outstanding shares upon request of the shareholder at any time. It is possible to do this on an equitable basis because the assets of mutual funds consist almost entirely of marketable securities and cash; and, therefore, the value of mutual fund shares may be computed at any time by adding up the market value of the portfolio shares plus cash and dividing this by the number of outstanding shares. The resulting figure is usually referred to as the "net asset value."

2. As a result of the redeemability feature, mutual funds must continuously sell new shares in order to avoid the slow forced liquidation of the fund because of redemptions.

3. If a mutual fund were to sell new shares for a price, after selling commissions, which is less than the net asset value or were to redeem outstanding shares at a price in excess of the net asset value, the equity of existing shareholders would be unfairly diluted. In order to avoid this, Section 22 of the Investment Company Act and the rules thereunder require that the net asset value

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[1] The characteristics of mutual funds enumerated in this paragraph are fully substantiated in the subsequent text.

be computed at least daily and in effect prohibit sales netting the fund less than that amount, or redemptions at prices above that amount.

4. By reason of the foregoing, the forces of supply and demand do not affect the price of mutual funds in the same way in which they affect the market value of other securities. There is an almost unlimited supply of new shares available at net asset value, plus selling commissions, and in the normal case no shares are available at a price below net asset value, since existing shareholders can always obtain net asset value by tendering their shares for redemption.

The Commission will discuss the following question:

Whether in the framework of the pervasive scheme of Securities and Exchange Commission regulation of mutual fund activities, established by the Investment Company Act of 1940 and the Maloney Act amendments to the Securities Exchange Act of 1934 ("Maloney Act"), a mutual fund, its underwriters and its dealers who have contracted with the underwriter to distribute the fund's shares ("contract-dealers") may lawfully agree, pursuant to Section 22(f) of the Investment Company Act,

1. to restrict the terms under which the underwriter and contract-dealers will conduct transactions with noncontract-dealers in the fund's shares ("inter-dealer transactions"); and
2. to exclude participation of contract-dealers as agents in sales of previously-issued fund shares by public investors ("brokerage transactions") which do not occur at the public offering price of the fund's shares, as stated in the fund's prospectus;

so long as such agreements are filed with the Commission as part of the fund's registration statement and are not in contravention of rules of the Commission adopted pursuant to Section 22(f).

STATUTES INVOLVED

Sections 22 (d) and (f) of the Investment Company Act of 1940, 54 Stat. 824, as amended, 15 U.S.C. 80a-22 (d) and (f), provide in pertinent part:

> (d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus
>
> *   *   *   *   *
>
> (f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Section 15A of the Securities Exchange Act, 15 U.S.C. 78*o*-3, which was added to the Exchange Act

through the 1938 Maloney Act Amendments, Public Law No. 719, 75th Cong. (52 Stat. 1070) is generally relevant to this lawsuit. Specific sections of the Maloney Act are discussed at pages 11 through 12 *infra.*

Section 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, provides in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal * * *.

STATEMENT

In this civil action under Section 4 of the Sherman Act, 15 U.S.C. 4, the United States seeks injunctive relief against the National Association of Securities Dealers, Inc. ("NASD"), certain open-end management investment companies ("mutual funds"),[2] mutual fund underwriters,[3] and securities broker-deal-

[2] Massachusetts Investors Growth Stock Fund, Inc.; Fidelity Fund, Inc.; and Wellington Fund, Inc. The Investment Company Act defines an open-end management investment company to be any issuer which (1) "is or holds itself out as being primarily * * * in the business of investing, reinvesting or trading in securities" (15 U.S.C. 80a–3); (2) is not a face-amount certificate company or a unit investment trust (15 U.S.C. 80a–4); and (3) is "offering for sale or has outstanding any redeemable security of which it is the issuer" (15 U.S.C. 80a–5).

[3] The Crosby Corporation; Vance, Sanders & Co., Inc.; and The Wellington Management Company, Inc. Section 2(a)(40) of the Investment Company Act defines Underwriter as a person who purchases shares from an issuer with a view to distribution or sells for an issuer in connection with a distribution of the issuer's shares (15 U.S.C. 80a–2(a)(40)).

ers,[4] for alleged violations of Section 1 of that Act. The complaint generally alleges that the defendants

> * * * combined and agreed to restrict the sale and fix the resale prices of the shares of open-end mutual funds in "secondary market" transactions between dealers, or from an investor to a dealer (collectively the "secondary dealer" or "interdealer" market), and between investors through a broker (the "brokerage market").

The district court, holding that the defendants' conduct was immunized from antitrust attack by the "pervasive regulatory scheme" established in Section 22 of the Investment Company Act, 15 U.S.C. 80a-22, and the Maloney Act Amendments to the Securities Exchange Act, 15 U.S.C. 78*o*-3, over the "narrow area of distribution and sales of mutual fund shares," granted the defendants' motions to dismiss the complaint "on the merits and with prejudice for failure to state a claim upon which relief can be granted." 374 F. Supp. at 114.

A. THE REGULATION OF MUTUAL FUNDS

As Chairman Garrett of the Commission recently had occasion to note "[n]o issuer of securities is sub-

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[4] Merrill Lynch, Pierce, Fenner & Smith, Inc.; Bache & Company, Inc.; Reynolds Securities Corp.; E. I. duPont, Glore Forgan, Inc.; E. F. Hutton, Inc.; Walston & Company, Inc.; Dean Witter & Company, Inc.; Paine, Webber, Jackson & Curtis, Inc.; and Hornblower & Weeks—Hemphill, Noyes, Inc. Section 2(a)(11) of the Investment Company Act defines Dealer as a person who buys and sells securities for his own account (15 U.S.C. 80a-2(a)(11)). Section 2(a)(6) of the Act defines Broker as a person who effects transactions in securities for the account of others (15 U.S.C. 80a-2(a)(6)).

ject to more detailed regulation than a mutual fund."[5] Regulation of mutual funds is generally accomplished through the Investment Company Act of 1940. Thus, the Court below explained that:

> * * * pursuant to the 1940 Act [mutual funds and other] investment companies must register themselves (§§ 7 and 8) and their shares [§ 24 (a)] with the SEC, update periodically their filings with quarterly and annual reports [§§ 30 (a)-(c)], and submit prospectuses and sales literature to the SEC [§ 24(b)]. Companies must issue to their shareholders, at least semiannually, financial reports containing specific types of information [§ 30(d)].
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> The 1940 Act also imposes detailed restrictions upon investment company structure, conduct, financial policies, and dealings with and by affiliates.[12]
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> [12] The Act delimits permissible methods for selecting directors of investment companies (and trustees in the case of investment trusts) (§ 16) sets out qualifications for securities custodians [§ 17(i)] and methods of safekeeping securities [§ 17(g)], and prohibits indemnification for official conduct [§§ 17(h) and (i)]. Certain persons guilty of prior malfeasance are barred altogether

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[5] Letter from Ray Garrett, Jr., Chairman, Securities and Exchange Commission to the Honorable John Sparkman, Chairman of the Committee on Banking, Housing and Urban Affairs, United States Senate (dated Nov. 4, 1974) ("Chairman Garrett letter") forwarding Report of the Division of Investment Management Regulation, *Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940* (August, 1974) ("Staff Report"). This report, which is discussed in greater detail *infra* at 21-26, 55-57, sets forth a wide ranging program for modification of the mutual fund distribution system including the orderly introduction of retail price competition, through the exercise of existing Commission regulatory authority, and through proposed legislative action.

from affiliating with investment companies, advisers, custodians, and principal underwriters (§ 9). Others who commit misconduct or abuse their positions of trust can be enjoined (§ 36). Misappropriation of company funds is made a federal crime (§ 37).

The Act also sets out minimum capitalization requirements for the companies (§§ 14 and 18). It requires a majority shareholder vote for changes in a company's open-end or closed-end nature, its diversification, its capacity to borrow money, issue senior securities, underwrite others' securities, purchase and sell real estate and commodities, or make loans, its investment policies, and its fundamental business (§ 13). Certain dividend distributions are barred unless timely disclosed to the shareholders [and the frequency of other distributions is limited] (§ 19). Investment companies are barred from participating in certain types of securities transactions [12(a)] and from making certain loans (§ 21). Some proxy solicitations are barred [§ 20(a)] and some exchanges need prior SEC approval (§ 11). Reorganization plans must be submitted to the SEC, which can render a * * * advisory report [if requested] and seek an injunction with respect to * * * reorganizations (§ 25). * * * Accountants must meet certain criteria, be selected in a particular fashion, and perform certain functions (§ 32). The regulated companies must keep and refrain from destroying certain books and records (§§ 31 and 34). Unit investment trusts (§ 26) and face amount certificate companies (§§ 28–29) are given special regulatory treatment.

The Act curtails the pyramiding of mutual funds [§§ 12 (d)–(g)]. Unless it is itself the principal underwriter, no investment company may acquire shares of another company whose principal underwriter is related to the first company [§ 10(f)]. At least 40% of the company's board must consist of independent directors (§ 10). Advisory contracts must first be approved by a majority of [disinterested] directors * * * and by a majority of shareholders [§ 15(c)]. Investment company transactions conducted by or with affiliated persons are prohibited in some cases and narrowly circumscribed in others (§ 17).

374 F. Supp. at 99.

Section 22 of the Investment Company Act sets forth the scheme of regulation of the process of distributing and marketing mutual fund shares. Section 22(d), with certain exceptions not relevant here, requires mutual fund underwriters and all dealers to maintain the public offering price established in a mutual fund's prospectus in sales of a mutual fund's shares to all purchasers, except the fund, its underwriters, or a dealer.[6] Sections 22(a) and 22(c) empower securities associations registered with the Commission under the Maloney Act[7] and the Commission itself to regulate the minimum prices at which securities broker-dealers may buy an investment company's shares from the fund, the maximum prices at which a broker-dealer may resell those shares back to the fund, the time for computing net asset value for purposes of determining the selling price, and the time that must elapse between purchase of the securities from the fund and resale to the fund. Section 22(b) empowers a registered securities association, that is the NASD, and the Commission, to prescribe the max-

[6] The current public offering price is composed of the daily prorated "net asset value" of the fund's portfolio of investments, plus a sales commission ("load") fixed by the fund. *See Complaint*, ¶ 11 (App. 8). *See also* Section 2(a)(40) of the Act, 15 U.S.C. 80a-2(a)(40); Investment Company Act Rules 22c-1 and 22d-1; 17 C.F.R. 270.22c-1, 270.22d-1.

[7] The NASD is the only such association to register with the Commission. It was incorporated in Delaware on July 18, 1939 and became registered under the Maloney Act on August 7, 1939. *National Association of Securities Dealers, Inc.*, 5 SEC 627 (1939).

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imum sales commission or "load"[8] to be charged to public investors who purchase securities from a dealer in connection with a primary distribution of those securities.[9] Finally, Section 22(f) authorizes mutual funds to restrict the transferability and negotiability of their shares so long as such restrictions are "in conformity with the statements with respect thereto contained in" the funds' registration statements and so long as those restrictions are not "in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company."

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[8] *See* note 6, *supra*.

[9] As the Antitrust Division correctly points out, Brief of Appellant at 6–7, in the case of mutual funds like the defendants, the primary distribution of new shares issued by the fund occurs through sales of the fund's shares by a principal underwriter "(often an affiliate of the fund)" to dealers with whom the underwriter has sales agreements, and then to the investors. The underwriter and dealers share the sales commission or "load" paid by the investors, typically with the larger portion going to the dealer. This method of distribution is to be distinguished from the method of distributing "no load open-end funds, which do not operate through dealers but sell directly to investors at net asset value." *Ibid.*

Also the defendants should be distinguished from " 'closed-end' investment companies, whose shares are not redeemable [as compared to those of open-end companies, see note 2, *supra*] and traditionally are traded in the pubic market at substantial discounts from asset value." *Ibid.*

Mutual fund shares may also be sold by means of "periodic payment plans," whereby the investor contracts to buy, in effect, a specified amount of fund shares over a period of time. Such periodic payment plans are themselves securities, and are regulated under Section 27 of the Investment Company Act, 15 U.S.C. 80a–27.

The Commission's regulatory authority under Section 22 is supplemented by its authority under Section 6(c) of the Act to grant exemptions, by way of rules, regulations or orders, from any provision of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of" the Act. Furthermore the Maloney Act gives the Commission extensive regulatory authority over the rules of registered securities associations. Thus, Section 15A(a) of the Act authorizes the Commission to set forth the matters which must be included in a registration statement of such an association and Section 15A (b) and (e) provide that an association shall not be registered unless the Commission is able to find that its rules meet certain standards. Section 15A(j) requires a registered association to file with the Commission amendments to its rules, and Section 15A(k) sets forth procedures whereby the Commission may alter, supplement, or amend the rules of a registered association. Furthermore, Section 15A(l)(1) authorizes the Commission to suspend or revoke the registration of a registered association. And, pursuant to Section 15A(g) and 15A(l)(2) the Commission is authorized to review any disciplinary action taken by an association against one of its members and to take action of its own to discipline a member of an association who has participated in a violation of the Securities Exchange Act, the Securities Act of

1933, or any rule or regulation adopted under those acts.[10]

The Court below found that the Commission has exercised the authority described above "actively [to regulate] * * * the pricing and distribution of mutual fund shares."[11] In particular, the Court noted that

> * * * for more than three decades, since the enactment of the 1940 Act, the agreements between dealers and principal underwriters and between principal underwriters and mutual funds [which set the terms under which fund shares are to be distributed] have been filed with the SEC. The agreements are filed under both the [Securities Act of 1933, 15 U.S.C. 77a, *et seq.*] and the 1940 Act. * * * The 1940 Act specifically calls for written contracts between funds and their principal underwriter [§ 15 (b)]. * * * [and] the Commission has approved a NASD rule which requires dealer-underwriter agreements; and Commission decisions have frequently turned on particular provisions of the dealer-underwriter agreements.[12]

B. THE ALLEGATIONS OF THE COMPLAINT

Count I of the Complaint alleges that the defendant NASD and its members, including the defendant

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[10] It should also be noted that Section 15A(n) provides:

"(n) If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail."

[11] 374 F. Supp. at 101. The opinion below contains an extensive recitation of the Commission's regulation of mutual fund pricing and distribution. *Id.* at 101–102.

[12] 374 F. Supp. at 101–102.

broker-dealers and principal underwriters, have combined and conspired "to prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares." Complaint, ¶16 (App. 9).[13] As part of this conspiracy the complaint alleges that the NASD and its members "established and maintained rules which inhibited the development of a secondary dealer market and a brokerage market in mutual fund shares." Complaint, ¶17(a) (App. 9). The Appellant has since indicated that it

> * * * is not challenging the validity of the NASD rules themselves, [but] only the appellees' activities that have resulted in unofficial interpretations and extensions of the rules to restrict secondary markets. The rules themselves apply only to the primary distribution of mutual fund shares and do not purport to fix prices or commission rates in the secondary interdealer or broker markets.[14]

Counts II and III of the Complaint allege violations of Section 1 of the Sherman Act in connection

[13] Pursuant to the Complaint "secondary dealer market" means an inter-dealer market in mutual fund shares and a market in which any dealer can purchase mutual fund shares from investors at more than the redemption price; and "brokerage market" means the transfer, by means of a brokerage transaction, of already issued and outstanding mutual fund shares between investors, acting through broker/dealers. Complaint, ¶3(g), (h) (App. 5).

[14] Brief of appellant at 51, n. 47. Accordingly, the issue of whether an NASD rule affords antitrust immunity to persons who act in compliance with such a rule is not before this Court. *Compare Harwell* v. *Growth Programs, Inc.*, 451 F. 2d 240 (C.A. 5), opinion on rehearing, 459 F. 2d 461, cert. denied, 404 U.S. 828.

with the distribution of Fidelity Fund shares. In Count II it is alleged that Crosby Corp., in its role as principal underwriter for the Fidelity Funds, entered into dealer agreements with the defendant broker-dealers to require that:

> (a) each broker/dealer must maintain the public offering price in any brokerage transaction in which it participates involving the purchase or sale of shares of the Fidelity Funds; and
>
> (b) each broker/dealer must sell shares of the Fidelity Funds only to investors or the fund and purchase such shares only from investors or the fund.

Complaint ¶¶ 22, 23 (App. 10–11).

Count III alleges that Fidelity Fund and Crosby Corp. have entered into contracts which require that "the dealer agreements" entered into between Crosby Corp. and broker-dealers contain the "restrictive provisions" quoted above which form the basis for the violation of Count II. Complaint ¶¶ 28–30 (App. 11–12).

Count IV alleges violations of Section 1 of the Sherman Act in connection with the distribution of a group of funds with respect to which defendant Vance, Sanders acts as principal underwriter ("Vance, Sanders Funds"). Specifically Count IV alleges that Vance, Sanders and the defendant broker-dealers entered agreements which require that

> (a) in all sales of shares of Vance, Sanders Funds to the public, the broker-dealer would act as dealer for its own account; and
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> (b) the broker-dealer would not purchase shares of Vance, Sanders Funds from other

> broker-dealers and would not sell such shares to other broker-dealers, or, in the alternative, would sell such shares to other broker-dealers only at the public offering price.

Complaint ¶ 35 (App. 13).

Count V alleges that Vance, Sanders and defendant Massachusetts Investors Growth Stock Fund have entered into and maintained contracts which require "that in all sales of shares of the Vance, Sanders Funds to the public, Vance, Sanders would act as principal for its own account." Complaint ¶ 41 (App. 14).

Counts VI and VII allege violations of Section 1 of the Sherman Act in connection with the distribution of shares of Wellington Fund, Inc. Count VI alleges that Wellington Management Company, Inc. ("Wellington"), in its role as principal underwriter of Wellington Funds, entered into contracts with the defendant broker-dealers which require that:

> (a) the broker-dealer must sell shares of the Wellington Funds only as principal, for its own account;
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> (b) the broker-dealer must not purchase shares of the Wellington Funds from other broker-dealers and must not sell such shares to other broker-dealers; and
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> (c) in all transaction involving Wellington and the other broker-dealers, Wellington would act only as agent for the appropriate Wellington Fund.

Complaint ¶ 47 (App. 15).

Count VII alleges that Wellington and Wellington Fund, Inc. have entered into contracts which require that:

(a) Wellington must forward all orders from investors or broker-dealers to the appropriate Wellington Fund for sale only at the public offering price; and

(b) Wellington would arrange for the purchase of shares only from the appropriate Wellington Fund.

Complaint ¶ 53 (App. 16).

Count VIII alleges that in addition to the allegations of Counts II, IV, and VI the defendant broker-dealers in violation of Section 1 of the Sherman Act have entered into and maintained contracts with other principal underwriters of mutual funds which contain one or more of the following restrictions:

(a) the broker-dealer must act as principal (dealer) only in the sale of such shares;

(b) if the broker-dealer acted as agent (broker) in the sale of such shares, it must maintain the public offering price;

(c) the broker-dealer must purchase such shares only from the principal underwriter, investors or the fund; and

(d) the broker-dealer must sell such shares only to the principal underwriter, investors, or the fund.

Complaint ¶ 58 (App. 17).

C. THE DECISION BELOW

Before discovery and trial the defendants moved to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6). Because it perceived the issues drawn upon those motions as strictly legal "as to which the facts as alleged in the complaint or otherwise are not rele-

vant" 374 F. Supp. at 98, the district court proceeded to an examination of the regulatory context in which the defendants' alleged conduct arose, and concluded that the complaint should be dismissed with prejudice.[15]

The district court reasoned initially that the case could "only be determined ultimately by an analysis of the several subsections of Section 22 of the 1940 Act and an antitrust exemption purportedly given by Section 15A(n) of the Securities and Exchange Act of 1934 (the Maloney Act), 15 U.S.C. 78*o*-3(n)." 374 F. Supp. 98. After reviewing the pervasive regulatory scheme over the process of mutual fund distribution, and the role of Section 22(d) in establishing resale price maintenance in the distribution of mutual funds, the district court rejected the appellant's argument

> * * * that Congress while allowing a primary market to flourish with benefit of antitrust immunity, did not intend to foreclose secondary market growth, but that such secondary markets are in fact being discouraged and suppressed by certain NASD rules and the restrictive provisions contained in the industry-wide uniform sales agreements between principal underwriters and dealers.

374 F. Supp. at 104.

Rather, the district court reasoned from the legislative history of Section 22, both as originally drafted

[15] The district court also dismissed with prejudice the complaints filed in two private cases which alleged essentially the same courses of conduct as are alleged in the appellant's complaint. *Haddad* v. *Crosby Corp.*, No. 2454-72 (D.D.C.); *Gross* v. *NASD*, No. 426-73 (D.D.C.).

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and as reviewed by subsequent Congresses in recent years, "that Congress designed § 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market." 374 F. Supp. at 109. Thus, the court found that Section 22(d) was intended, through the mechanism of resale price maintenance imposed on contract and non-contract dealers in sales to investors, to eliminate certain abuses resulting from "the cut-price competition" that the court found to have existed between the primary distribution market and the secondary market in mutual fund shares prior to 1940. 374 F. Supp. at 105–106. These abuses included discrimination in the prices charged similarly situated investors and disruption of the primary distribution system. *Id.*

Similarly, the district court found that as another method of overcoming the "disruptive influence upon the market in mutual fund shares by the practices of non-contract dealers and brokers" Congress through Section 22(f) provided

> * * * that if (1) restrictions on transferability or negotiability are included in the registration statement, and if (2) these restrictions are not in contravention of such rules and regulations as the commission may prescribe in the interests of the shareholders, then such restrictions are permissible even if they create departures from antitrust standards.

374 F. Supp. at 108. Thus, the district court found that "Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market

which existed at the time and in full recognition of the antitrust implications." 374 F. Supp. at 109. Further, the court noted that "restrictions on alienability have consistently appeared in registration statements and uniform sales agreements" filed with the Commission since passage of the Investment Company Act and the Commission, while noting the existence of these provisions, has never made any attempt to prohibit them. *Ibid.*

When this regulatory scheme was scrutinized in light of this Court's prior pronouncements concerning the resolution of other regulatory schemes and the "fundamental economic policy" represented by the antitrust laws, the district court found that the conduct challenged by the appellant was entitled to a "limited antitrust exemption." 374 F. Supp. at 114. The Court concluded that

> * * * Congress clearly intended to substitute a pervasive regulatory scheme, *i.e.*, § 22 of the 1940 Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is [therefore] clear that the price maintenance practices complained of are immune from ordinary antitrust strictures.

Ibid.

THE INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Investment Company Act of 1940 vests in the Commission pervasive authority to regulate the process of distributing mutual fund shares and the role of retail price maintenance in that process. As will be seen, this grant of jurisdiction reflects Congress' determination that the complex process of balancing

conflicting public policy considerations required in regulating mutual fund distribution made that area appropriate for administrative oversight rather than direct, rigid legislation.

Over the last decade, however, the continued appropriateness of retail price maintenance in the process of mutual fund distribution has come under increasing question by the Commission and by Congress. Thus, in 1969 the Senate Committee on Banking and Currency of the Ninety-First Congress considered legislation to repeal Section 22(d), but after receiving "impressive testimony * * * that there had not been sufficient study of the consequences of such an amendment" that committee requested the Commission "to review the consequences of such a proposal on both the investing public and mutual fund sales organizations." [16]

In response to this mandate and after extensive study the Commission published SEC, *Report of the Staff on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* (November, 1972) ("Staff Study"). The Staff Study and the Commission deliberately refrained, however, from

> * * * making any definitive recommendations to the Congress as to what should or should not be done about Section 22(d), [rather the Commission will] hold public hearings at which interested persons will be asked to direct [the Commission's] attention to aspects of the mu-

[16] S. Rep. No. 184, 91st Cong., 1st Sess. 8.

tual fund sales compensation problem that the report may have overlooked or to which it may have given insufficient weight.[17]

Subsequently, after holding hearings on a broad range of subjects related to the distribution of mutual fund shares,[18] the Commission forwarded to Congress a report prepared by its Division of Investment Management Regulation entitled *Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940* (August, 1974) ("Staff Report"). The Staff Report sets forth a wide-ranging administrative and legislative program for the reduction or elimination of "many of the inequities and inefficiencies of the present fund distribution system" as well as "the gradual and orderly introduction of retail price com-

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[17] Letter of transmittal of Staff Study from SEC Chairman William J. Casey to the Honorable John Sparkman, Chairman of the Senate Committee on Banking, Housing and Urban Affairs (November, 1972) at vi.

[18] *See* Investment Company Act Release No. 7475 (November, 1972) which outlined the issues to be considered in the hearings as follows:

A. Repeal of Section 22(d) of the Act.
   1. Complete repeal.
   2. Partial repeal.
   3. Price competition within a limited range.
   4. A current public offering price described in the prospectus.
   5. Prohibit price competition from non-contract dealers.

B. Rules under Section 22(b) and other provisions of the Act.
   1. Lower breakpoints reflecting the reduced cost of diversification on larger purchases.
   2. Regulation of the dealer-discount.
   3. Continuous discounts.

petition into the mutual fund distribution system." [19]

The Commission's approach to effectuation of this program was influenced by its realization that

> * * * Implicit in the decision of Congress to establish a thoroughgoing statutory scheme to govern mutual funds is * * * a determination that mutual funds are a product which, with appropriate safeguards, should be made available to the public.[20]

Accordingly, the Commission was not "prepared to take or recommend action which might result in an abrupt end to fund distribution." [21] Therefore, the Commission's program took "a middle path intended to reduce or eliminate many of the inequities and inefficiencies of the present fund distribution system while, at the same time, avoiding the dangers of a sudden abolition of retail price maintenance." [22]

As part of this program which has been developed over five years, the Commission announced that it

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4. The value of additional product features.
5. Contractual plans.

C. Further liberalization of advertising rules.
1. Advertising.
2. Statement of Policy.

D. Simplified more readable mutual fund prospectuses.
E. Group sales.
F. Reducing paperwork in small transactions.
G. No-load sales.
H. Development of an adequate economic data base.

In addition, persons participating in the proceeding were invited to address relevant issues other than those enumerated. The hearings were held in February and March, 1973. Some seventy persons appeared and more than 100 written comments were filed. Chairman Garrett letter, *supra*, n. 5 at iii.

[19] Chairman Garrett letter, *supra*, n. 5 at v.

[20] *Ibid.*

[21] *Ibid.*

[22] *Ibid.*

intends to take action with respect to the very conduct at issue in this lawsuit, that is, contractual agreements between mutual funds, their underwriters and contract dealers which may have the effect of restricting secondary market transactions in mutual fund shares. Thus, with respect to *brokerage* transactions the staff report made a recommendation (which the Commission adopted) that the NASD be requested to amend its rules to prohibit, with certain appropriate qualifications, contractual provisions in the sales agreements between principal underwriters and contract dealers, which require either that a broker-dealer refrain from acting as agent in a sale of already issued shares between two investors or, if it does act as agent that it nevertheless maintain the public offering price.[23] This action, the report explained, would, in the context of the gradual introduction of retail price competition, help "to develop price sensitivity among investors" and would provide "important insight into whether a secondary *dealer* market could function effectively."[24] The Staff Report further noted that if the NASD refused to adopt such a rule, or if funds attempted to bypass the rule by directly restricting the transferability of shares in brokered transactions, then the Commission could take direct regulatory action under Section 22(f).[25]

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[23] Staff Report at 104–109. The Commission has since sent a letter to the NASD requesting this action. *See* p. 56, *infra*.

[24] *Id.* at 105.

[25] *Id.* at 105. The report also noted that the Commission could prohibit these restrictions under Section 15(c)(2) of the Securities Exchange Act, 15 U.S.C. 78*o*(c)(2), which provides:

"(2) No broker or dealer shall make use of the mails or

The Staff Report also recommended that the Commission ask Congress to clarify the Commission's authority to effect an administrative abolition of the retail price maintenance requirements of Section 22 (d) when such action becomes appropriate during the course of the Commission's program.[26] In this connection, the Staff Report expressed concern as to whether or not a secondary market in fund shares maintained by noncontract dealers would have an adverse effect on the primary distribution process during the period of adjustment to retail price competition. Further, the staff noted that underwriters would be unable to charge secondary market dealers for their fair share of costs incurred in the distribution, such as advertising, which would benefit all dealers. This fact could, in the view of the Staff Report, result in unfair competitive advantages to the secondary market dealers, again disrupting the distribution process.[27] Accordingly, the Staff Report suggested the possibility of prohibiting the development of a sec-

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of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation. The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious."

[26] Staff Report at 115–121.

[27] *Id.* at 119, 120.

ondary non-contract dealer market in fund shares for some period during the introduction of price competition, and further suggested allowing funds and underwriters to impose fair costs on the secondary market dealers in order to eliminate disruptive competitive advantages which may accrue to those dealers.[28]

As will be seen, the contractual provisions challenged under the antitrust laws in this lawsuit are precisely the kind of restrictions on transferability and negotiability of mutual fund shares which Congress authorized in Section 22(f), absent limiting Commission rules. The Commission's determination at the present time not to exercise its authority under Section 22(f) to totally eliminate those restrictions can only be taken to mean that in the context of its present regulatory program involving mutual fund distribution, it does not view that action as appropriate. Yet, the appellant, in this lawsuit, seeks to reverse that regulatory judgment of the Commission by asserting that the defendants' conduct, in contractually restricting the development of secondary broker and inter-dealer markets of fund shares, violated the antitrust laws and can be enjoined under the antitrust laws.

[28] This secondary market in mutual fund shares maintained by non-contract dealers, about which the Commission has expressed reservations, is, of course, the "inter-dealer market" which the Antitrust Division seeks to establish through this lawsuit. Accordingly, the appellant was incorrect in asserting that the Commission Staff Report "did not discuss the inter-dealer market." Brief of Appellant at 39, n. 34.

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Granting the injunctive relief sought by the appellant would therefore reverse Congress' legislative judgment, recognized by the court below, that the elimination or modification of the mutual fund marketing structure "mandated by Congress in 1940" "is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide." 374 F. Supp. at 109. Similarly, granting the plaintiff's requested injunctive relief would impede the very exercise of Commission regulatory authority that Congress contemplated and provided for in 1940.

SUMMARY OF ARGUMENT

The basic question on this appeal is whether the defendants may, free from the antitrust laws, contractually restrict the terms under which the defendant underwriters and dealers trade in shares of the defendant funds. These contractual restrictions were entered into in the context of the primary distribution of mutual fund shares, which, as discussed above, is regulated by the Securities and Exchange Commission under the Investment Company Act and the Maloney Act.

While "[r]epeal of the antitrust laws is not to be lightly assumed"[29] they are nevertheless impliedly repealed to enable a federal regulatory scheme to work.[30] In the present case a searching inquiry into the gen-

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[29] *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289, 303.

[30] *See Silver* v. *New York Stock Exchange, Inc.*, 373 U.S. 321, 357.

esis and aims of the regulatory scheme[31] reveals that Congress intended, through Section 22 of the Investment Company Act, to give the Commission power to regulate the distribution of mutual fund shares and the secondary market of those shares. In particular Congress intended, through Section 22(f), to curb certain abuses occurring in the secondary market of fund shares by authorizing mutual funds and their underwriters to control and restrict secondary markets in their shares, subject to Commission regulation. This regulatory scheme will not work if activity authorized under Section 22(f), which the Commission does not prohibit, can be challenged under the antitrust laws.

ARGUMENT

THE CONTRACTUAL PROVISIONS WHICH FORM THE BASIS OF THIS LAWSUIT ARE SUBJECT TO REGULATION BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE FEDERAL SECURITIES LAWS, AND IN PARTICULAR UNDER SECTION 22(f) OF THE INVESTMENT COMPANY ACT, AND ARE IMMUNE FROM ANTITRUST ATTACK

A. THE ORIGINS OF SECTION 22

Because it noted a similarity between problems related to the control and management of investment companies and problems involving the control and

[31] *See*, *e.g.*, *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 732, 736–739; *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 373–74; *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 350–352; *United States* v. *R.C.A.*, 358 U.S. 334, 339–376. *See also Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117.

management of public utility holding companies, Congress, in 1935, through Section 30 of the Public Utility Holding Company Act, 15 U.S.C. 79z-4, directed the Commission to make a study of investment trusts and investment companies and to direct its findings to Congress.[32] In response to that mandate, the Commission prepared its *Report on Investment Trusts and Investment Companies,* Parts One through Five (1939-1941) (Investment Trust Study).

The Investment Trust Study focused particular attention on problems and practices related to the distribution of shares of open-end investment companies (or mutual funds) like the defendants in this case.[33] Underlying the structure of mutual fund distribution, as well as "other factors, such as capital structures, investment policies and management discre*tion*",[34] the study noted, were two essential features:

> (1) The continuous offering of securities at prices which will net the fund amounts equivalent to the net asset value of each outstanding share at the time of sale; and
>
> (2) The obligation of the investment company to redeem or repurchase its outstanding shares by paying the equivalent of the net asset value per share (in some cases less a small redemption fee.) [35]

These features had the practical effect of stabilizing the price of mutual fund shares since an investor

[32] S. Rep. No. 621, 74th Cong., 1st Sess., p. 10.

[33] *See generally*, Investment Trust Study, Part II, at 211-222, 241-244; Part III, at 799-874.

[34] Investment Trust Study, Part III at 799.

[35] *Id.*, Part III at 799; Part II at 213-214.

would always receive asset value for his shares upon redemption.[36] On the other hand, the obligation to redeem also posed a threat that redemptions may be greater then sales, thus resulting in dimunition of the fund's assets with the possibility of forcing liquidation of the fund.[37] This threat of "substantial redemptions" influenced fund management to concentrate their investments in well known shares which could be readily liquidated to meet redemption demands.[38] It also caused the funds continuously to market their shares and to place great emphasis on the success of their sales programs.[39]

At the top of the distribution mechanism was the principal distributor or underwriter who contracted with the company "to buy its shares or act as agent in their sale at a price which will net the company an amount equal to their asset value." [40] The underwriter was usually affiliated with the sponsor of the fund, and the organization hired by the fund to manage its portfolio.[41]

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[36] *Id.*, Part III at 806; Part II at 241.

[37] *Id.*, Part III at 806–809.

[38] *Id.* at 806, 820–823.

[39] *Id.*, Part III at 801, 807–808, 856. The importance placed on a continuous marketing program in 1940 can be seen from the observation of the Investment Trust Study "that for each dollar invested in open-end investment companies as of the end of 1936 it was necessary to market almost three dollars worth of shares." *Id.* at 809.

[40] *Id.*, Part II at 214–215; Part III at 823.

[41] *Id.*, Part II at 215; Part III at 804, 823; *see also* Hearings Before a Subcommittee of the Senate Committee on Banking and Currency on S. 3580, 76th Cong., 3d Sess., at 152 (Senate Hearings).

From the underwriter, fund shares were then distributed to investors through a network of dealers organized for the fund by a group of middlemen or wholesalers.[42] The price to the investor was, at least in theory, composed of a sum related to the net asset value of the fund's shares plus a sales load intended to compensate the members of the selling chain.[43] When a fund was threatened by increased redemptions there usually resulted "increased selling pressure [by providing salesmen] with higher loading charges to overcome the diminution in the size of the company caused by the redemptions."[44] Similarly, competition among funds to obtain and retain dealers had the effect of preventing "the reduction of loading charges."[45]

Because mutual fund shares could always be redeemed at net asset value, there was apparently no incentive to develop a secondary exchange market in fund shares.[46] However, the Investment Trust Study

[42] Investment Trust Study, Part II at 215.

[43] *Ibid.*

[44] *Id.*, Part III at 856.

[45] *Id.*, Part III at 826. A study of the mutual fund industry forwarded to Congress by the Commission in 1966 revealed that the same distribution process was operating at that time, including the same relationship between selling pressure and the size of sales loads. Securities and Exchange Commission, *Report on the Public Policy of Implications of Investment Company Growth*, H. Rep. No. 2337, 89th Cong., 2d Sess. at 54.

[46] Investment Trust Study, Part III at 805, 855. Furthermore, the fact that open-end companies were continuously issuing and redeeming shares on the basis of net asset value made the price of open-end shares relatively impervious to the forces of supply and demand, except insofar as a high rate of redemption might tend to cause higher sales loads. *Id.* at 855.

revealed that secondary over-the-counter markets in mutual fund shares did exist.[47] These markets were maintained in part by dealers and underwriters who were part of the distribution chain of a particular fund.[48] The secondary market of these persons involved purchasing shares from investors for the underwriter's or dealer's own account (instead of turning them into the fund for redemption), and then immediately reselling those shares to other investors.[49] In the case of a dealer, this type of transaction resulted in increased profits because the distributor, not having furnished the shares, received no portion of the sales load.[50] These persons also maintained inventories in a fund's shares (the shares being purchased either from investors or from the fund) and would service their customers' orders out of their inventory when the price paid for the inventory shares was less than the public offering price—thus potentially retaining both the sales load and any increase in net asset value between the time the inventory share was purchased and the time it was resold to an investor.[51] Furthermore, in the case of a dealer, all element of

[47] The Investment Trust Study suggests that the secondary over-the-counter market in mutual fund shares which was operating in 1940 was a dealer market, rather than a brokerage market in which investors sold their shares through an agent. *Id.*, Part II at 327.

[48] *Id.*, Part III at 856–857.

[49] *Id.*, Part II at 242; Part III at 805, 809, 856–863.

[50] *Id.*, Part II at 242; *cf. Id.*, Part III at 859.

[51] *Id.*, Part III at 859.

risk was removed by the operation of the "two-price" system (see p. 33–35, *infra*).

Another kind of secondary market activity was engaged in "by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors for those companies." [52]

In the cases of both types of secondary market activity described above the bid price was normally slightly higher than the redemption price of the fund and the asked price was slightly less than the price in the primary distribution of the fund.[53] With respect to the activity of unauthorized dealers the Investment Trust Study noted:

> * * * In an active market the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price.[54]

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[52] *Id.* at 865.

[53] *Id.* at 857, 865. Because the secondary market bid price was a little more than the redemption price, retiring investors were induced to sell their shares in the secondary market rather than redeeming their shares with the fund. Another factor enabling secondary market dealers to induce shareholders to sell their shares instead of redeeming was that the dealer could offer the outgoing shareholder immediate cash payments, whereas if the shares were redeemed, their exact value might not be computed until the next day. *Id.* at 857.

[54] *Id.*, Part III at 865 (footnotes omitted).

The Investment Trust Study also noted, with respect to secondary dealer market activity generally, "that there was considerable activity by dealers in switching customers from one open-end investment company to another." [55]

In addition to the secondary markets which operated at the retail level, the Investment Trust Study also noted the existence of certain "trading firms" which apparently competed with the underwriters and wholesalers by selling to dealers at a discount from the price available from the underwriters and wholesalers.[56] The Investment Trust Study used the term "bootleg market" with respect to, variously, (1) the market made by trading firms; [57] (2) the secondary market made by unauthorized dealers; [58] and (3) the market which "bids higher and offers at lower prices than the principal distributor." [59]

The Investment Trust Study noted that the existence of secondary dealer market activity in mutual fund shares was related to another aspect of the

[55] *Id.* at 809; *see also Id.*, Part II at 221. Switching activity was detrimental to the investor because he had to pay a new load each time he purchased new shares. *Id.*

[56] Investment Trust Study, Part II at 325–328. The study indicates that the trading firms "bought chiefly from other dealers, presumably both other wholesale firms and retail dealers." *Id.* at 327.

[57] *Id.*, Part II at 328, n. 85.

[58] *Id.*, Part III at 865. *See also*, Heffernan & Jorden, *Section 22(d) of the Investment Company Act of 1940—Its Original Purpose and Present Function*, 1973 Duke Law Journal, 975, 978 ("Heffernan & Jorden").

[59] Investment Trust Study, Part II at 241, n. 100.

mutual fund distribution process operating in 1940—the series of abuses and practices related to the "two-price" system. The "two-price" system resulted from what was then a commonly used method of computing the net asset value of a fund's shares.[60] By this method the net asset value of a fund's shares was computed on the basis of the fund's portfolio value at the close of the trading markets on the previous day. But, even though the markets closed some time in the afternoon, the new price did not go into effect until the next morning. Accordingly, between close of the market on one day, and the time when the price became effective on the next day, there were two operative prices for the fund's shares, the price in effect during the trading day and the price that would go into effect for the next day.[61]

Because the differential between the two prices was very rarely greater than the load, public investors were generally not able to take advantage of this two-price system.[62] But, dealers were allowed by funds to purchase shares for their own accounts from the principal distributor and other dealers at a discount from the public load. This ability to purchase at discount enabled a fund's dealers, and to some extent its principal distributor, to take advantage of their foreknowledge of the next day's prices for the fund's

[60] *Id.*, Part III at 851; Senate Hearings at 187.

[61] *See generally*, Investment Trust Study, Part III at 850–855; Senate Hearings at 135–159, 835–863; Heffernan & Jorden at 979–981.

[62] Investment Trust Study, Part III at 862.

shares in order to engage in "riskless trading" in the fund's shares.[63]

Certain insiders of funds also had the advantage of being able to purchase shares at a discount from the published load and therefore could engage in riskless trading.[64] Riskless trading had the effect of diluting existing shareholders' equity since the person who purchased shares under such circumstances became immediately entitled to redeem his shares on the next day for more than he had paid into the fund.[65]

The Investment Trust Study lists a variety of means used by funds to combat the various problems discussed above related to the distribution process. With respect to the secondary markets maintained by unauthorized dealers "certain open-end companies * * * [restricted] the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company."[66] Thus, one company stated in its prospectus that its shares were "non-transferable, in the absence of the consent of the corporation, unless the registered holder * * * has first offered same

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[63] *See generally*, Investment Trust Study, Part II at 218–220, Part III at 856–865; Heffernan and Jorden at 979–984.

[64] Investment Trust Study, Part III at 871, Senate Hearings at 289, 660–61, 1057, Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 10065, 76th Cong., 3d Sess. at 58–59 (House Hearings); H. Rep. No. 2639, 76th Cong., 3d Sess. at 8 (House Report); S. Rep. No. 1775, 76th Cong., 3d Sess. at 7 (Senate Report).

[65] Investment Trust Study, Part III at 865–867; Senate Hearings at 138–139.

[66] Investment Trust Study, Part III at 861.

to the corporation and it has failed to purchase the shares."[67]

Certain open-end companies also attempted to limit the abusive trading practices related to distributors' and contract dealers' over-the-counter market trading, and riskless trading, under the two-price system by imposing limitations on the right to purchase and sell their shares.[68] These limitations often involved prohibiting the underwriter from taking any trading position in the fund's shares and requiring the underwriter to fill only bona fide orders received by dealers from their customers.[69] Another device used by one company was to distribute directly through dealers rather than an underwriter. "The selling contracts [used by this company] did not permit dealers to make resales of shares to persons other than bona fide investors without the consent of the investment company nor at any prices other than the established sales premiums."[70]

Following its Investment Trust Study the Commission submitted its recommendations for legislation in identical bills to the Senate and House, S. 3580 and

[67] *Id.* at 865, n. 342.

[68] *Id.*, Part III at 867–874.

[69] *Id.* at 867–869.

[70] *Id.* at 871. The Investment Trust Study also describes the direct elimination of the "two price" system by certain companies through the means of computing the sales and redemption prices based on the value of the fund's portfolio at close of the day the order is received. *Id.* at 870–874. This method of "foreward pricing" a fund's shares for redemption and sales purposes was eventually mandated for the industry by Investment Company Act, Rule 22c-1, 17 C.F.R. 270.22c-1.

H.R. 9835.[71] As explained by Senator Wagner in introducing S. 3580, that bill was intended to go beyond the "full and fair disclosure" regulation of previous federal securities laws and to "eliminate and prevent those deficiencies and abuses in [investment companies] * * * which have contributed to the tremendous losses sustained by their security holders."[72] S. 3580 was designed

> * * * to eliminate wherever possible * * * [abuses and deficiencies in the organization, sales of the securities and operation of investment companies] by direct prohibition of their continuance. Only in the comparatively few cases where the problems are complex and technical is a regulatory power vested in the Commission to correct malpractices by rules, regulations or orders promulgated in accordance with precise standards prescribed in the bill.[73]

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[71] 76th Cong., 3d Sess. *See generally*, Heffernan & Jorden at 984.

[72] Cong. Rec. Daily, March 14, 1940, at 4412. In introducing S. 3580 Senator Wagner noted that with regulation, investment companies could become an important financial institution in the national economy. *Id.* at 4413.

[73] *Id.* at 4413; *see also*, Senate Hearings at 45. One important regulatory authority granted the Commission in S. 3580 and H.R. 9835 was Section 6(c). That section, which survived subsequent redrafting of the bill as a whole to be retained in the same position and virtually the same form in the Investment Company Act (see p. 11, *supra*), provided:

"* * * The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security or transactions from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that the Commis-

Section 22 of the proposed legislation authorized the Commission "to adopt rules and regulations to protect investors against dilution of their equity caused by pricing abuses in the distribution and redemption" of investment securities and to prohibit "grossly excessive" sales loads on mutual fund securities.[74] Section 22 of S. 3580 and H.R. 9835 provided in relevant part:

> SEC. 22 (a) No registered investment company or principal underwriter therefor shall sell, redeem, or repurchase any redeemable security of which such a company is the issuer, except at a price bearing such relation to the current asset value of such security, computed as of such time, as the Commission shall prescribe by rules and regulations or orders, for the purpose of eliminating or reducing to a practical minimum any dilution of or accretion to the current asset value of any other securities of such company as a consequence of such sale, redemption, or purchase.
>
> (b) No underwriter or dealer in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, shall purchase any such security from the issuer or from any underwriter except at the price at which he sells such

sion finds such exemption necessary or appropriate in the public interest and consistent with the protection of investors." This "broad exemptive power" was intended to allow the Commission to correct the harmful effect of any complete prohibition of conduct contained in the statute which "does not work out." Senate Hearings at 293.

[74] Cong. Rec. Daily, March 14, 1940, at 4414. *See also* Senate Hearings at 288.

security, less a commission or spread allowed him by the person selling to him.

*   *   *   *   *

(d) The Commission is authorized by rules and regulations or order in the public interest or for the protection of investors, to prohibit—

*   *   *   *   *

* * * (2) restrictions upon the transfer ability or negotiability of any redeemable security of which any registered invest-vestment company is the issuer." [75]

David Schenker, Chief Counsel for the Investment Trust Study, explained in the Senate Hearings on S. 3580 [76] that Section 22(a) of that Bill was intended to give the Commission "power to formulate rules and regulations" to deal with "the possible dilution of the equity of certificate holders in open-end companies." [77] Section 22(b) was intended to eliminate "riskless-trading" by "dealer[s] or 'insiders' or people who are 'in the know' " and who were in a position to purchase securities under the two price system.[78]

Finally, Section 22(d)(2), Mr. Schenker explained, authorized the Commission to make "rules and regu-

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[75] Section 22(c) authorized the Commission to prohibit the sale of investment company securities at grossly excessive loads. Section 22(d)(1) authorized the Commission to adopt rules to prohibit the suspension of the redemption privilege of an investment company's securities.

[76] The House did not hold hearings on S. 3580's companion bill, H.R. 9835, 76th Cong., 3d Sess.

[77] Senate Hearings at 288; Mr. Schenker noted that the investment company industry expressed some concern over Section 22(a) because they thought "it may have some undesirable consequences in connection with their distribution activities." *Ibid.*

[78] *Id.* at 289.

lations with respect to any restrictions upon the transferability and negotiability of any redeemable security of which any registered investment company is the issuer."[79] This provision, he went on, was intended to deal with the "technical problem" of the "bootleg market" in which

> * * * dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company.[80]

By way of example Mr. Schenker referred to "some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company."[81] Mr. Schenker stated that while he recognized that the bootleg market was a "big problem," it seemed to him that such restrictions "are taking away a big portion of the owner's right of initiative."[82] Mr. Schenker further recommended that rather than mandating an explicit provision in the statute, the subject "ought to be a matter of rules and regulations."[83]

In other testimony on S. 3580 representatives of the Commission and the mutual fund industry debated extensively on how best to regulate the problems of dilution and riskless trading by insiders caused by the

[79] *Id.* at 292.
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*
[83] *Id.* at 293.

two-price system.[84] The industry, while agreeing that regulation was necessary, argued that the problem of dilution caused by the activities of dealers and underwriters should be regulated by the industry itself through the mechanism of the Maloney Act.[85] The industry also argued that riskless trading by insiders should be prohibited through a prohibition on the sale of securities by an investment company "to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors."[86]

The regulation of restrictions on transferability and negotiability contained in Section 22(d)(2) of S. 3580 generated little comment in the Senate Hearings other than the testimony of one member of the industry that such restrictions imposed by funds he was affiliated with were intended "for the protection of the shareholders, as well as of the management" of the funds.[87]

Subsequent to the Senate Hearings on S. 3580 representatives of the Commission and of the industry conferred over their various differences with respect to that bill and eventually produced a memorandum of agreement on legislation that both sides could sup-

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[84] *See* Senate Hearings at 135–153, 288–289, 514–528, 548–556, 612, 660–661, 672–674, 836–863, 940–941, 1057, 1085–1095. *See also*, Heffernan and Jorden at 984–994.

[85] Senate Hearings at 525, 660, 1057.

[86] *Id.* at 1057. This suggestion appears to have been modeled on a regulation of the Division of Securities of the State of Ohio. *Id.* at 526–527, 548–554. *See also*, Heffernan & Jorden at 988–993.

[87] Senate Hearings at 708–709.

port.[88] Later a bill reflecting this memorandum was prepared, which, with amendments by the House not relevant to this case, became the Investment Company Act of 1940.[89]

The memorandum of agreement provided that the "subject matter of subsections (a), (b) and (c) of Section 22 [of S. 3580] * * * relative to pricing, dilution and load" would be dealt with in the following manner:

> (a) an express provision authorizing an association under the Maloney Act (for example, N.A.S.G. [sic]) to make rules covering this subject matter.
>
> (b) a grant of equivalent power to the Securities and Exchange Commission, provided that the same shall not be exercised for one year from the effective date of the act.
>
> * * * * *
>
> No security issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer, except on the same terms as are offered to other investors. * * *[90]

The memorandum of agreement also provided that "restrictions on transferability of shares shall be subject to rules and regulations of the Commission."[91] These provisions of the memorandum of agreement are reflected in Sections 22 (a), (b), (c), (d), and (f) of the Investment Company Act.

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[88] *Id.* at 1105–1109; Hearings on H.R. 10065 Before the House Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess. at 71–72, 96.

[89] S. 4108 and H.R. 10065, 76th Cong., 3d Sess.

[90] House Hearings at 99.

[91] *Ibid.*

The legislative history thus reveals that Section 22 of the Investment Company Act was intended to provide Securities and Exchange Commission regulation over the abuses and practices which the Investment Trust Study noted in connection with the distribution of, and secondary market trading in, mutual fund shares. Subsections (a) and (c) were intended to deal directly with the dilution problem as it related to trading by dealers in the underwriting chain. Subsection (b) dealt with the problem of excessive loads charged by persons in the primary distribution process.

The similarity between subsection (d) and the recommendations by representatives of the investment company industry as to the appropriate method for curbing riskless trading by insiders, suggests that the elimination of discriminatory prices to insiders was at least one purpose of that subsection.[92] This same result could have been accomplished by some other method,[93] however. In view of this fact, and in view of the fact that Section 22(d) requires both contract dealers and secondary market dealers to sell only at the public offering price stated in the fund's pro-

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[92] *Accord* Heffernan & Jorden at 978.

[93] *See* Heffernan and Jorden at 993 where the authors note that Congress considered eliminating riskless trading by insiders through the imposition of a holding period like that contained in Section 16(b) of the Securities Exchange Act, 15 U.S.C. 78p(b), and through the prohibition of the two-price system, but that neither of these measures was incorporated in the Investment Company Act. The two-price system in the sale of mutual fund shares is now in effect prohibited by Investment Company Act Rule 22c-1, 17 CFR 270.22c-1, adopted in 1968. *See also* Brief of Appellant at 29–30.

spectus, it is probable that Section 22(d) also manifests a Congressional intent to protect contract dealers from the price competition of a secondary dealer market.[94] This purpose of Section 22(d) is further suggested by the fact that prior to the passage of S. 4108, secondary market dealers in mutual fund shares apparently alerted the Commission and the Senate to the consequences of Section 22(d) to their business in an unsuccessful attempt to have that section amended.[95]

Subsection (f) of Section 22, however, was clearly intended to allow funds to restrict over-the-counter transactions in their shares subject to Commission regulation. This is evident from the testimony of Mr. Schenker (*see* pp. 39–40, *supra*) that Section 22(f)'s predecessor was related to the problem of the bootleg market as well as the similarity between Section 22 (f)'s use of the term "restrictions on transferability and negotiability" and the devices which, as discussed above, the Investment Trust Study alluded to with respect to mutual fund attempts to control the second-

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[94] *Accord*, Heffernan and Jorden at 993.

[95] *See* Exhibits A and B, Reply Memorandum in Support of Motions by the Defendant Dealers to Dismiss the Complaints, *United States* v. *National Association of Securities Dealers*, No. 338–73 (D.D.C.) filed July 20, 1973 (App. 309–322). Thus, a memorandum on Section 22(d) of S. 4108, which was submitted to the Commission prior to the passage of S. 4108 by a firm which engaged in secondary market transactions in fund shares without participating in the primary distribution system, after analyzing Section 22(d), concludes that that section was designed to "effectively hamper [non-contract] * * * dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly." *See* Exhibit A, *supra* (App. 315).

ary market activities of dealers in their shares. Indeed, the appellant concedes in its brief that Section 22(f) was intended to deal with the issues created by the bootleg market.[96]

B. THIS LAWSUIT MUST BE VIEWED IN THE CONTEXT OF THE RETAIL PRICE MAINTENANCE SCHEME ESTABLISHED IN SECTION 22(d) OF THE INVESTMENT COMPANY ACT

The District Court held that "the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d)."[97] Insofar as this holding suggests that a secondary *brokerage* market is inconsistent with Section 22(d), the Commission does not concur. The Commission has repeatedly taken the position that Section 22(d) does not prohibit brokered transactions in fund shares at other than the public offering price.[98] Further, as noted above (see p. 23, *supra*), the Commission has recently followed the recommendation of its Staff Report that under present conditions in the mutual fund industry it is appropriate for it to take steps to bring about a secondary brokerage market in mutual fund shares so long as certain safeguards are also adopted.[99]

But the Commission's determination to introduce a measure of price competition into the process of mar-

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[96] Brief of Appellant at 32, n. 27.

[97] 374 F. Supp. at 104.

[98] Opinion of the General Counsel, Investment Company Act Release No. 78 (March 14, 1941) 11 Fed. Reg. 10992; *Oxford Co., Inc.*, 21 S.E.C. 681, 690 (1946); letter from Chief Counsel, Division of Investment Management Regulation to George A. Bailey, Jr. (April 24, 1973) (App. 247); Staff Report at 104.

[99] Staff Report at 104–109.

keting mutual fund shares through the development of a secondary brokerage market should not be taken to indicate that the retail price maintenance policy of Section 22(d) should no longer be given any effect. As noted above, Section 22(d), *inter alia,* manifests an intention to protect the primary distribution process of mutual fund shares from any disruptive effect caused by price competition from a secondary *dealer* market. Furthermore, it is undisputed that Section 22(d) has had the effect of eliminating the only significant source of price competition to the primary distribution process of mutual fund shares which existed prior to 1940—the secondary dealer market. The development of the mutual fund industry under 30 years of retail price maintenance, and Congress' refusal to repeal that section without greater study, require that any modification of retail price maintenance in the mutual fund industry be accomplished by the Commission through a carefully considered regulatory program, so as not to cripple the mutual fund industry.[1]

Accordingly, it is necessary to view the conduct at issue in this lawsuit in the context of the retail price maintenance scheme established by Section 22(d). This perspective reinforces the Commission's basic

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[1] The Commission itself is granted broad authority under Sections 6(c) and 38(a) of the Investment Company Act, 15 U.S.C. 80a-6(c), 80a-38(a) as well as under the Maloney Act to regulate the scheme of retail price maintenance which is mandated for the mutual fund industry by Section 22(d). *See Baum* v. *Investors Diversified Services, Inc.*, 286 F. Supp. 914 (N.D. Ill.), affirmed on other grounds, 409 F. 2d 872 (C.A. 7, 1969).

argument that Section 22 of the Investment Company Act, taken together with the rest of the Act, and with the Maloney Act, constitutes an integrated scheme mandated by Congress for the regulation of the pricing and distribution of mutual fund shares by the Commission, and further, that as part of that integrated scheme the contractual restrictions alleged in Counts II–VIII of the Complaint are authorized by Section 22(f).

C. THE CONTRACTUAL PROVISIONS ALLEGED IN COUNTS II–VIII OF THE COMPLAINT ARE RESTRICTIONS ON TRANSFERABILITY AND NEGOTIABILITY WITHIN THE MEANING OF SECTION 22(f) AND ARE NOT IN VIOLATION OF THE OTHER REQUIREMENTS OF THAT SECTION.

As the Appellant points out in its brief:

> * * * A fund is authorized by Section 22(f) to impose * * * restrictions only if they are fully disclosed in the fund's registration statement, and, in any event, they must not contravene rules and regulations of the Commission.[2]

The Appellant argues, however, that the contractual provisions alleged in Counts II through VIII do not qualify under Section 22(f) because (1) they are not fund-imposed but rather are contractual "agreements between principal underwriters and funds and between underwriters and broker-dealers";[3] and (2) because these contractual agreements involve "restraints of the distribution mechanism rather than restraints on the alienability or negotiability of the

[2] Brief of Appellant at 43.
[3] *Ibid.*

fund shares themselves."[4] Apparently, the only conduct that the Appellant would accept as constituting a restriction on transferability or negotiability within the meaning of Section 22(f) is a restrictive legend printed on a fund certificate at the behest of the issuer.

Underlying the Appellant's argument with respect to Section 22(f) is a presumption against the validity of fund-imposed restrictions on transferability and negotiability. This presumption, however, is inconsistent with the legislative history of that section. As the legislative history discussed above demonstrates, restrictions on transferability and negotiability were imposed by funds to combat a number of practices occurring in the secondary market of their shares which were harmful to investors, including dealers switching investors between funds, the dilution of funds' assets as a result of riskless trading by dealers, and the disruption of the funds' distribution systems with the consequent threat that the funds might be thrown into a net redemption situation.[5]

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[4] *Ibid.*

[5] While the Appellant concedes in a footnote that Section 22(f) was directed to the issues of the bootleg market, Brief of Appellant at 32, n. 22, its only textual discussion of the legislative history of Section 22(f) is the assertion that that section

"* * * was intended to limit the practices of certain funds whose share certificates specified that the shares were not transferable except by redemption with the fund. Quite often those restrictions were not disclosed to investors before they purchased the shares. Because such restrictions deprived the investor of a valuable ownership right, Congress required their disclosure in the registration statement and authorized the Commission to regulate them."

The implication of this legislative history that the drafters of the Investment Company Act considered restrictions on transferability and negotiability consistent with the broad regulatory purposes of the Act is further strengthened by the only significant amendment of the language of Section 22(d)(2) of S. 3580 and H.R. 9835 that was incorporated in Section 22(f). The original section required that the Commission's rules regulating restrictions on transferability and negotiability be "in the public interest and for the protection of investors." (See p. 39, *supra.*) As ultimately stated in the Investment Company Act, however, the Commission's rules under Section 22(f) are required to be "in the interests of the holders of all of the outstanding securities of such investment company." This standard clearly requires the Commission to look to the remedial function of restrictions on transferability and negotiability, as well as to their effect upon competition. Section 22(f) thus bespeaks Congress' endorsement of restrictions on transferability and negotiability subject to Commission regulation.

Brief of Appellant at 44-45.

There is simply nothing in the legislative history cited by the Appellant in support of the above statement supporting its assertion that restrictions on transferability and negotiability were not disclosed. And, in the Senate Hearings on S. 3580 one industry representative testified with respect to restrictions on transferability and negotiability imposed by his funds that:

"* * * When the stockholders of our two funds bought these shares, they knew that they could sell them only to the trusts themselves."

Senate Hearings at 708.

In view of this endorsement by Congress of the remedial purpose of restrictions on transferability and negotiability, it is necessary that Section 22(f) "be construed broadly to effectuate its purpose." *Tcherepnin* v. *Knight,* 389 U.S. 332, 336. The appellant's insistence that the conduct alleged in Counts II through VIII does not fit under Section 22(f) defies this cannon of statutory construction. Thus the appellant's argument that the "contractual restrictions on distribution here involve restraints on the distribution mechanism rather than restraints on the alienability or negotiability of the fund shares themselves"[6] confuses the manner in which these restraints are effected with the question of whether they fall within Section 22(f).

Contrary to the assertion of the appellant prior precedents interpreting Section 22(f) support the view that the conduct alleged in Counts II through VIII does constitute restrictions on transferability and negotiability within the meaning of that section. Soon after the adoption of the Investment Company Act the Commission had occasion to review whether NASD Rule 26, which was adopted to curb many of the abuses noted in the legislative history of the Investment Company Act, complied with the standards of Section 15A(b)(8) of the Maloney Act.[7] Section (j)(2) of Rule 26 prohibited NASD members who are underwriters of a mutual fund from repurchasing mutual fund shares from certain classes of dealers or from any investor unless such persons are the record holders of the securities being repurchased.

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[6] Brief of Appellant at 43.

[7] *National Association of Securities Dealers*, 9 SEC 38.

The Commission characterized this section as a "restriction upon the transferability of securities" comparable to the restrictions dealt with in Section 22(f).[8] Similarly, the Appellant itself, in testimony during the Commission's hearing on repeal of Section 22(d), has asserted that fund-imposed requirements that only owners of record may redeem their shares and that actual delivery of shares must precede redemption are restrictions on transferability within the meaning of Section 22(f).[9]

These precedents reflect Congress' intention to regulate, through Section 22(f), restrictions on secondary market activities in mutual fund shares. Counts II through VIII allege a course of conduct intended to restrict the secondary market activity of dealers and underwriters in fund shares. To the extent that these pleaded allegations of the Appellant are true, then such conduct must, by the Appellant's own definition, involve restrictions on transferability and negotiability within the meaning of Section 22(f).

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[8] 9 SEC at 44–45, n. 10.

[9] Comments of the United States Department of Justice, Mutual Fund Distribution Hearings (File No. 4–164) (February 2, 1973) at 14 citing Staff Report at p. A–58. *See also*, Testimony of Daniel Hunter, trial attorney for the Appellant in this case, *id.* at 2089–2090. The appellant's present argument, that Section 22(f) refers only to restrictions on the face of a fund's shares, Brief of Appellant at 43, is based on its attempt to raise Mr. Schenker's example of a restriction on transferability and negotiability, given in his Senate testimony on Section 22(d)(2) of S. 3580, to the dignity of the exclusive conduct covered by that section. *See* Senate Hearings at 292. In this connection, it is worth noting that the example of a restriction on transferability intended to curb bootleg market activity which is referred to in the Investment Trust Study, involves a restriction contained in the fund's prospectus rather than one

The Appellant also argues that Section 22(f) only authorizes fund imposed restrictions on transferability and negotiability rather than restrictions contained in contracts between underwriters and dealers.[10] But this argument again loses sight of the context in which these restrictions arise. Both the appellant's own brief (Brief of Appellant at 6) and the history of the Investment Company Act recognize that there is usually a close affiliation between a mutual fund and its principal underwriter. Furthermore, Sections 15 (b) and (c) of the Investment Company Act, 15 U.S.C. 80a–15 (b), (c), taken together, require principal underwriters of mutual funds to have a written contract with the fund. Such contracts must be approved by a majority of the fund's disinterested directors and cannot continue for more than two years unless approved annually by the board of directors or by a majority of the shareholders. Also, the principal underwriters who are defendants in this case are required, by NASD Rule 26, to enter into agreements with dealers who distribute their funds. The fund is required to file those agreements with the Commission, as well as the underwriting contract between the

stamped on the face of its shares. Investment Trust Study, Part III at 865.

[10] This argument, of course, can only be made with respect to the conduct alleged in Counts II, IV, VI and VIII of the complaint since Counts III, V and VII allege fund imposed restrictions rather than underwriter imposed restrictions. Furthermore, it should be noted that the conduct alleged in Count III involves an agreement between Fidelity Fund, a mutual fund, and Crosby Corp., its principal underwriter, to "obligate" Crosby Corp. to enter into the restrictive agreements alleged in Count II, thus making the restrictions in Count II the result of actions by Fidelity Fund. *See also*, Brief of Appellant at 11.

fund and its principal underwriter.[11] In view of these circumstances, and in view of the broad effect that must be given to Section 22(f), where the contractual restrictions alleged in Counts II through VIII have in fact been filed with the Commission by the fund, such restrictions clearly involve the kind of conduct Congress intended to be authorized in Section 22(f), subject to Commission regulation.

D. THE CONDUCT ALLEGED IN COUNTS II THROUGH VIII IS IMMUNIZED FROM ANTITRUST ATTACK BY SECTION 22(f) OF THE INVESTMENT COMPANY ACT

As discussed above, the conduct alleged in Counts II through VIII of the Complaint constitutes restrictions on transferability and negotiability of mutual fund shares which are authorized by Section 22(f) absent Commission rules prohibiting such conduct. Despite the Commission's awareness of the challenged conduct for several decades, it has not deemed it necessary to adopt rules prohibiting such conduct.[12] The Appellant urges, however, that Section 22(f) does not displace the antitrust laws but "merely provides further limitations on a fund's restriction of the transferability of its shares." Brief of Appellant at 44.

This argument ignores this Court's often repeated pronouncement that the antitrust laws will be considered repealed to the extent that they are repugnant to

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[11] 1 CCH F. Sec. L. Rep. ¶ 71,777, Item 1 (Form S-5); 3 CCH F. Sec. L. Rep. ¶ 51,296, Item 6 (Form N-8B-1).

[12] The Commission has, however, indicated that in the context of its program to introduce increased price competition in the distribution of mutual fund shares it will, if necessary, exercise its authority under Section 22(f) to prohibit any fund-imposed restrictions on a secondary *brokerage* market. Staff Report at 105, n. 1. *See* p. 23, *supra*.

a federal regulatory scheme. *Silver* v. *New York Stock Exchange, Inc.*, 373 U.S. 341, 357; *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 350–351. Section 22(f) manifests a presumption in favor of restrictions on the transferability and negotiability of mutual fund shares, subject to Commission regulation. But Commission regulation under that section is to be guided by a standard different from the "public interest" standard embodied in other regulatory schemes. While the interests of the holders of all the outstanding certificates of a mutual fund include a right to the protection afforded by the national policy in favor of competition,[13] Congress intended that the prohibition on restrictions on transferability and negotiability not be accomplished at the expense of protection against switching, dilution and disruption of the distribution system. It would nullify the effect of this grant of regulatory authority to the Commission for this Court to hold that a district court may apply antitrust principles to conduct like that alleged in Counts II through VIII, when the expert body designated and empowered by Congress to regulate and supervise that conduct has not heretofore deemed it appropriate to prohibit the conduct.[14]

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[13] *Compare Gulf States Utilities* v. *Federal Power Commission*, 411 U.S. 747; *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726; *Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 43 U.S.L. Week 4091, 4096–4097 (U.S., decided December 23, 1974).

[14] In order to bolster its argument that Section 22(f) is not inconsistent with the antitrust laws, the Appellant observes that "Appellees have not contended that Section 22(f) preempts state law requirements, [for restrictions on transferability and negotiability] and there is no basis for such a claim." Brief of Appellant at 48. The question of whether the conduct

The repugnancy between the antitrust laws and the regulatory scheme here involved is particularly evident in the present lawsuit. It is undisputed that the contractual agreements alleged in Counts II through VIII have been filed with the Commission pursuant to the Investment Company Act. Furthermore, the record of this case,[15] and the public record,[16] reflect that the Commission and the Commission's staff have been personally aware of these restrictive provisions and have not taken action to eliminate them. Further, as noted above, in its program for introducing retail price competition into the mutual fund industry the Commission has determined not to take the precipitous action requested by the appellant in this lawsuit. The Commission has determined to eliminate, initially through NASD rules, contractual agreements which inhibit secondary brokerage transactions in fund shares. But in requesting the NASD to take this action, the Commission made clear that

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challenged in Counts II through VIII can be characterized as restrictions on transferability and negotiability within the meaning of state law, and what effect Section 22(f) would have on state law if such a characterization were appropriate, is simply not before this Court. That conduct does fall within the meaning of Section 22(f), however, and as such, is immune from federal antitrust attack so long as it complies with the requirements of that section.

[15] *See* Exhibit 16 to Affidavit of Daniel R. Hunter in Support of Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss, *United States* v. *National Association of Securities Dealers*, No. 338–73 (D.D.C., filed July 16, 1973) (App. 274–275).

[16] *First Multifund of America, Inc.*, Investment Company Act Release No. 6700, CCH F. Sec. L. Rep. ['70–71 Transfer Binder] ¶ 78,209 at 80,602, n. 7; *Mutual Funds Advisory, Inc.*, Investment Company Act Release No. 6932 (1972) at 7 (Dissent of Commissioner Loomis).

> * * * action in this area should also include steps to help to neutralize any adverse impact on the funds' primary distribution systems and to insure that transactions in a brokered market are in the interests of all of the holders of the funds' outstanding shares."[17]

Similarly, the Commission's Staff Report indicated that it would approach cautiously the introduction of a secondary non-contract dealer market during its program to introduce retail price competition into the mutual fund distribution system. The direct result of the inter-dealer market which the appellant seeks to introduce through this lawsuit, however, would be to encourage the development of such a non-contract dealer market which would compete with the funds' primary distribution system.

The appellant's prayer for relief simply does not reflect any concern for these policies of the Investment Company Act.[18] The granting of the appellant's prayer

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[17] Letter from Ray Garrett, Jr., Chairman, Securities and Exchange Commission to Mr. Gordon S. Macklin, President, National Association of Securities Dealers, Inc., dated November 22, 1974. Chairman Garrett further explained:

"* * * For example, funds would be permitted to impose reasonable service fees when ownership of their shares is transferred in this manner. In the absence of any underwriter's spread on the sale, such fees could include the cost of recording the transfer as well as an amount to compensate the underwriter, to some extent, for promotional services. To ensure that broker-dealers engage only in the genuine matching of orders, they should not be permitted to fill orders to buy or sell fund shares more than one full business day after such orders are received. Nor should broker-dealers be required to set up special procedures to match orders for fund shares."

[18] *See* Complaint at 20–22 (App. 18–19).

for relief would be inconsistent with a regulatory judgment of the Commission and would interfere with the Commission's program. Any review of the Commission's action should not occur under the inappropriate standards of the antitrust laws.[19] Rather the Commission's judgment should be considered under the standards of the acts which it administers.[20] Otherwise the authority of the Commission "to conclude that preservation of a competitive structure in a given case is overridden by other interests," [21] would be meaningless.

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[19] Under Section 4(d) of the Administrative Procedure Act, 5 U.S.C. 553, any interested person may petition an administrative agency for the issuance, amendment or repeal of any rule of that agency. And Section 10(d) authorizes a federal district court to "compel agency action unlawfully withheld or unreasonably delayed." 5 U.S.C. 706.

Moreover, Section 10(a) of the APA, 5 U.S.C. 702, generally affords judicial review to persons "adversely affected or aggrieved by agency action within the meaning of a relevant statute * * *," as well as to any "person suffering legal wrong because of agency action." *See Independent Broker-Dealers' Trade Association* v. *Securities and Exchange Commission*, 442 F. 2d 132, 141–143, *certiorari denied*, 404 U.S. 828 *cf. PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission*, 485 F. 2d 718, 726, 733 (C.A. 3), *certiorari denied*, 416 U.S. 969.

[20] McLean Trucking Co. 1. United States, 321 U.S. 67, 79–80, 85–88 (Interstate Commerce Commission). *Cf., California Gas Producers Association* v. *Federal Power Commission*, 421 F. 2d 422, 428–29 (C.A. 9), *certiorari denied*, 400 U.S. 819; *Cities of Statesville* v. *Atomic Energy Commission*, 411 F. 2d 962, 987 (C.A. D.C.. (Leventhal J. concurring); *Northern Natural Gas Co.* v. *Federal Power Commission*, 399 F. 2d 953, 961 (C.A. D.C.).

[21] *Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 95 S. Ct. 438, 448.

It is therefore evident that, to the extent that the contractual restrictions alleged in Counts II through VIII of the Complaint have been filed with the Commission as part of fund registration statements under the Investment Company Act, those restrictions are immunized from antitrust attack by the regulatory scheme of mutual fund distribution embodied in the Investment Company Act, and in particular by Section 22(f) of that Act. This antitrust immunity does not apply to all conduct of mutual funds or even to all contractual agreements between mutual funds, their principal underwriters, and dealers. But within the context of the pervasive scheme of regulation of investment company activity administered by the Commission, Congress intended that in the narrow area of restrictions on transferability and negotiability of mutual fund shares, the competitive principles of the antitrust laws would be tempered with protection against secondary market transactions by dealers involving dilution of fund assets, unfair switching of investors between funds, and disruption of fund distribution systems. Application of the Sherman Act to conduct subject to this regulatory scheme would frustrate the goals of Congress in establishing that scheme.[22] Accordingly, consistent with this Court's past pronouncements, the antitrust laws should be considered impliedly repealed as to conduct clearly subject to the Commission's jurisdiction under subsec-

[22] *Compare Baum* v. *Investors Diversified Services, Inc.*, 286 F. Supp. 914 (N.D. Ill.) affirmed on other grounds, 409 F. 2d 872 (C.A. 7).

tion (f) of Section 22 of the Investment Company Act of 1940.[23]

CONCLUSION

For the reasons stated, the judgment of the district court dismissing the complaint should be affirmed.

Respectfully submitted.

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Securities and Exchange Commission.

I authorize the filing of the foregoing brief.

ROBERT H. BORK,
Solicitor General.

JANUARY 1975.

[23] *Compare Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 385, n. 14; *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296.

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Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

REPLY BRIEF FOR THE UNITED STATES

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1. Appellees, like the Securities and Exchange Commission ("SEC") as *amicus curiae*, misconceive the government's contentions. In summary, the complaint charges in Count I a horizontal combination and conspiracy among members of appellee National Association of Securities Dealers, Inc., to restrain trade in outstanding mutual fund shares by suppressing secondary inter-dealer and secondary brokerage markets. Counts II through VIII allege vertical combinations to suppress such markets through provisions both in sales agreements between broker-dealers and principal underwriters and in underwriting agreements between the named principal underwriters and their mutual funds. The government recognizes that Section 22(d) of the Investment Company Act of 1940, 54 Stat. 824, expressly provides for and requires resale price maintenance with respect to transactions within its terms, *i.e.*, sale at the "current public offering price"

in the primary distribution of mutual fund shares, and in all sales of such shares by dealers to investors if the shares are being currently offered to the public by or through an underwriter. 15 U.S.C. 80a-22(d).

Section 22(d), however, expressly permits underwriters and dealers to sell at any time to other dealers or to the issuing fund at prices other than the vertically-fixed current public offering price. Thus, as the SEC has consistently held since the Act was adopted (see U.S. Br. 35-41), "the offering price is not required to be maintained in the case of sales in which both the buyer and the seller are dealers acting as principals in the transaction." Investment Company Act Release No. 78, March 4, 1941, 11 Fed. Reg. 10992.

Similarly, Section 22(d) does not affect direct sales by investors to each other or sales by investors executed through a broker; as the SEC has "repeatedly" held, "Section 22(d) does not prohibit brokered transactions in funds shares at other than the public offering price" (SEC Br. 45).

2. Like the appellees, however, the SEC is mistaken when it implies (*id.* at 25, n. 28, 56) that this antitrust suit seeks to establish a secondary market in which non-contract dealers, as principals, compete unfairly in the sale of outstanding shares to investors. The secondary dealer market that we contend is permitted by Section 22(d) extends no further than to sales by dealers to other dealers, to the issuing fund itself, or to its underwriters. Regardless of how or from whom he acquired the shares, if the dealer sells for his own account to an investor we do not dispute that the statute now requires that he sell at the current public offering price if such shares are being currently offered to the public by the fund (see

U.S. Br. 7, n. 7, 23, 35). Rather, this suit challenges the collective efforts of the appellees, for the purpose of suppressing the secondary inter-dealer (properly understood) and brokerage markets, to extend the limited resale price maintenance authorized and required by Section 22(d) beyond its carefully-defined limits. Such conduct violates the Sherman Act. *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384; *United States* v. *McKesson & Robbins, Inc.*, 351 U.S. 305, 316.[1]

The SEC's recent Report on Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940 ("1974 Report") is not directed at dealer sales to other dealers; its focus is on the sale of mutual fund shares by dealers to investors. The portions of the Report concerning limitations on the "secondary dealer market" necessary to prevent "non-contract dealers" from securing unfair competitive advantages over contract dealers (*id.* at 115-121) were addressed to the proposal that Section 22(d) be substantially amended or repealed. If that were to occur, so that dealers could sell outstanding shares to investors at less than the vertically-fixed price, then the report suggested that limitations on the secondary dealer market might be necessary so that non-contract dealers selling to investors could not unfairly take a "free ride" in the promotional efforts paid for by the principal underwriter and its contract dealers. Under existing law, secondary inter-dealer transactions involve no sales to investors and do not raise this "free rider" problem.

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[1]The dilemma posed for the appellee dealers by the need "to walk the tightrope" between criminal liability under the antitrust laws and under the securities laws (Bache Br. 51, n. 106) is illusory. A dealer would be criminally liable under the securities laws only for if it *willfully sold* fund shares "in cut price '*dealer*' transactions" (*ibid.*), whereas it would be criminally liable under the antitrust laws only for *agreeing not to sell* "in cut price 'broker' transactions * * *" (*ibid.*). A broker-dealer's *sale* as dealer at the public offering price would not violate the antitrust laws.

3. Appellees' varied contentions that Section 22(f) authorizes the broad vertical restrictions alleged in Counts II through VIII is not supported by its language or history. Joined by the SEC (*e.g.*, SEC Br. 50-52), appellees contend, in essence, that Section 22(f) authorizes not only "restrict[ions on] the transferability or negotiability" of fund shares (15 U.S.C. 80a-22(f)), but also any contractual arrangement between a fund and its principal underwriter or between the latter and broker-dealers that has the same effect as such restrictions. That argument, however, imputes to Congress a degree of imprecision on this matter that contrasts sharply with the drafting of the other provisions of the Act (see, *e.g.*, U.S. Br. 21-22). For example, the Act refers elsewhere to contracts between funds and their principal underwriters (*e.g.*, 15 U.S.C. 80a-15(b)), and it cannot be assumed that Congress meant the specific language of Section 22(f) to apply to all contractual arrangements that might have effects comparable to the restrictions there described.[2]

Moreover, Congress and the SEC anticipated that competition by funds would regulate sales loads,[3] and re-

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[2]If Section 22(d) had the effect that appellees now ascribe to it of requiring that the current public offering price be maintained in all inter-dealer and brokerage transactions, as well as those in the primary distribution chain, it would not have been necessary for the funds, underwriters and dealers to attempt to achieve that result through the contractual restrictions they now seek to justify under Section 22(f).

[3]In the Senate Hearings on the Investment Company Act of 1940, David Schenker, Chief Counsel for the Investment Trust Study, testified that "for the present, at least, we ought to leave that [the sales load issue] to competition among the different distributors." Hearings before a Subcommittee of the Senate Committee on Banking and Currency, on S. 3580, Part 1, 76th Cong., 3d Sess., p. 290.

In the Hearings preceding the Investment Company Act Amendments of 1970, SEC Chairman Cohen stated:

> For twenty-seven years we have been observing the effects of this compromise system hammered out in the summer of 1940. For twenty-seven years the Commission has waited for price com-

strictions on the distribution of shares would have been inconsistent with this expectation. Only in the sale of fund shares to investors was competition expressly restricted, as provided in Section 22(d). The potential for competition beyond the limited provisions of Section 22(d) for resale price maintenance was not eliminated by Section 22(f). On the contrary, that Section was intended to require disclosure of restrictions on the transferability or negotiability of mutual fund shares and to empower the SEC to eliminate or regulate such restrictions "in the interests of the holders of all of the outstanding securities of such investment company." 15 U.S.C. 80a-22(f).

The Commission has never adopted rules under Section 22(f) *requiring* funds to impose restrictions against secondary and brokerage markets, nor has it ever indicated that such restrictions are necessary. The claim that the Commission's silence on this issue represents an ongoing determination that such restrictions are proper is untenable, for inaction or acquiescence by a regulatory agency in the absence of a statutory obligation to act forms no basis for implying immunity from the antitrust laws. *United States* v. *Borden Co.*, 308 U.S. 188, 198-201; *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 225-227; see *Baltimore & O. Ry.* v. *Jackson*, 353 U.S. 325, 330-331.

If the SEC, exercising its powers under Section 22(f), were to order funds to impose such restrictions upon their shares, presumably no antitrust liability could arise if

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petition among mutual funds to materialize. It hasn't. [Hearings before the Senate Committee on Banking and Currency, on S. 1659, 90th Cong., 1st Sess., p. 152; accord, Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce on H.R. 9510, 9511, 90th Cong., 1st Sess., pp. 57, 142 ("1967 House Hearings").]

funds did so. *United States* v. *Borden Co., supra*; *Parker* v. *Brown*, 317 U.S. 341. But the SEC has not done so.[4] To the contrary, recognizing the danger that the long-suppressed brokerage market could not come into being if the transferability and negotiability of shares were restricted, the SEC itself has warned the NASD and the funds that if they attempt to bypass the SEC's recent proposals under Section 22(d) for a secondary brokerage market by directly restricting the transferability of sales in broker transactions, then the SEC may act under Section 22(f). 1974 Report 104-109. Such action by the SEC will of course be unnecessary if existing vertical restrictions are held to violate Section 1 of the Sherman Act.

In claiming that this antitrust action will inevitably intrude into areas reserved exclusively to the Commission, several appellees have stressed the prayer for relief in the government's complaint (Fidelity Br. 15-16; Wellington Br. 40-42; see also SEC Br. 26, 56-57). The sufficiency of a complaint against a motion to dismiss is governed, however, not by the specific relief requested, but by whether, based on the allegations of the complaint, any relief (including only declaratory relief) might be appro-

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[4]In applying the doctrine of federal preemption to asserted conflicts between state law and federal regulatory authority, an issue that this Court has said is analogous to application of the doctrine of implied repeal to "conflicting federal regulatory schemes" (*Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 126-127), the Court has often required that the agency unequivocally act so as to create an *actual* conflict before preemption will be found. See, *e.g., Head* v. *New Mexico Bd. of Examiners*, 374 U.S. 424, 432; *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 236-237; *Penn Dairies, Inc.* v. *Milk Control Comm'n*, 318 U.S. 261, 278; *H. P. Welch Co.* v. *New Hampshire*, 306 U.S. 79, 83-85. See also *Rice* v. *Chicago Bd. of Trade*, 331 U.S. 247, 255-256.

priate (see U.S. Br. 16-17).[5] Although no question of the propriety of any particular form of relief is now before the Court, when the question of relief is reached in this case the district court could include in a decree appropriate provisions taking into account such action as the SEC had then taken or might take. Cf. *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 375; *United States* v. *Terminal Ry. Ass'n*, 224 U.S. 383, 412.[6]

4. Appellees' reliance upon the legislative history of the 1970 amendments to the Investment Company Act and prior legislative proposals is misplaced. In the Investment Company Amendments Act of 1970, 84 Stat. 1413, Congress amended Section 22(b) of the Act to give the NASD jurisdiction to adopt rules prohibiting sale loads that are "excessive" rather than merely those that are "grossly excessive" (15 U.S.C. 80a-22(b)) and also reenacted Section 22(d) in full, with only a technical change. 84 Stat. 1422, 1423.

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[5]Noting that several of the appellees accompanied their "motions to dismiss" with documents and affidavits (see A. 117-224, 309-310), and that the government submitted documents in response (A. 230-308), several appellees have suggested that the Court may treat the case as if summary judgment motions had been granted upon the basis of a complete factual record reflecting the fruits of full discovery (*e.g.*, Fidelity Br. 34-36). The district court, however, properly considered the appellees' motions to dismiss as raising "strictly legal" issues concerning the complaint itself (J.S. App. 33, n. 8), and took no note of any of the additional factual submissions. In any event, the implication that the documents submitted by the government—many of which indicate that the appellees have in the past acknowledged the propriety (if not the desirability) of a competitive secondary market (*e.g.*, A. 265-269) — reflect fully what might be developed by discovery and trial, is unfounded.

[6]The government's action does not seek damages. Whether plaintiffs who have filed similar treble damage actions would be entitled to recover damages (assuming proof of injury during the four-year period of limitations) is also an issue the Court need not consider at this time. Compare *Simpson* v. *Union Oil Co.*, 396 U.S. 13, 14; *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 105-109.

The legislative history shows that Congress was primarily concerned with excessively high sales loads and advisory fees in the mutual fund business. The SEC had originally proposed to remedy the sales load problem by placing a five percent ceiling on the sales loads authorized by Section 22(d), but subsequently reached an agreement with industry representatives to give the NASD authority to prevent "excessive" sales loads, similar to its authority to regulate fairness in the over-the-counter markets. Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737, 91st Cong., 1st Sess., pp. 182, 865 ("1969 House Hearings"). Because of the limited knowledge about the effect of total abolition of resale price maintenance in the mutual fund industry,[7] the pertinent Senate committee asked the SEC to study the effect of repeal of Section 22(d) and to transmit its findings, when complete, for possible legislative action. 1969 House Hearings 183.

Congress' failure in 1970 to amend or repeal the resale price maintenance provisions of Section 22(d) therefore signifies nothing more than a reluctance to act without some estimation of the effects of its action. Cf. *Zuber* v. *Allen*, 396 U.S. 168, 185-186, n. 21 ("Congressional inaction frequently betokens unawareness, preoccupation, or paralysis"). The principal issue being outright repeal of Section 22(d) and elimination of resale price mainte-

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[7]According to SEC Chairman Budge:

> The reason the Commission did not recommend the repeal of section 22(d) was because it was represented to us by the industry that disaster would result from the repeal of section 22(d). We had no meaningful way of measuring whether or not that was true and simply on a conservative basis we did not want to make the recommendation without more knowledge about it. [1969 House Hearings at 183.]

nance in the primary distribution chain, the hearings and reports understandably did not focus on secondary brokerage or inter-dealer transactions, which are presently of limited significance (U.S. Br. 9-10). See *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 477-478.

Like the district court (J.S. App. 53), appellees stress[8] an extemporaneous response by then SEC Chairman Cohen, in testifying three years prior to the 1970 amendments, in which he made an oversimplified statement of the scope of Section 22(d) during intense questioning by Congressman Watkins concerning the SEC's alleged infringements on states' rights and "competitive business." In this context, in attempting to show that interference with competition in the mutual fund business in general reflected the action of Congress, not the Commission, Chairman Cohen stated (1967 House Hearings 711):

> I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.

This characterization of Section 22(d) was overstated, for it failed to include the significant qualification that the fixed resale price provision applies to the sale of fund shares only when the fund is currently offering such shares to the public. Nor can it properly be regarded as a considered repudiation of the SEC's longstanding interpretation of Section 22(d). Significantly, the SEC itself, in its *amicus* brief, fails to mention Chairman Cohen's statements. To the contrary, the SEC explicitly rejects the district court's conclusion (and the appel-

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[8]See Bache Br. 75; Fidelity Br. 32, n. 41; NASD Br. 35-36; Wellington Br. 37.

lees' contention), based on that testimony, "that a secondary *brokerage* market is inconsistent with Section 22(d) * * *" (SEC Br. 45; emphasis in original).[9]

5. Having held that the SEC has exclusive jurisdiction over the subject matter of the government's antitrust complaint, the district court stated that "the cases at bar do not involve the doctrine of primary jurisdiction" (J.S. App. 66, n. 59). The broker-dealer appellees contend in passing (Bache Br. 119, n. 297) that the case should be referred to the SEC if the latter's jurisdiction is not held to be exclusive.

If this Court agrees with our contention that the SEC does not have exclusive jurisdiction, then the question of the SEC's primary jurisdiction, which has not been briefed, should be left for the district court to consider in the first instance with other issues on remand. See *Thill* v. *New York Stock Exch.*, 469 F.2d 14, 15 (C.A. 7); cf. *Ricci* v. *Chicago Mercantile Exch.*, 409 U.S. 298.[10] We note only that the SEC's views as to secondary brokerage and inter-dealer markets have been on record since 1941 (see U.S. Br. 35-39), and in its recent Mutual Fund Report it has ruled that impediments to a secondary brokerage market are inconsistent with the general objectives of the securities laws. Since the agency has already spoken, "in prior releases or opinions," there would seem to be no need to

[9]With respect both to appellees' and the SEC's references to interpretations of Section 22(d) by dealers who would be adversely affected by it or by the NASD's actions in implementing it and to the views of opponents seeking its repeal (*e.g.*, Bache Br. 55-57; SEC Br. 44, n. 95; Wellington Br. 34), we note this Court's caution "against the danger, when interpreting a statute, of reliance upon the views of its * * * opponents. In their zeal to defeat a bill, they understandably tend to overstate its reach." *National Labor Relations Board* v. *Fruit & Vegetable Packers*, 377 U.S. 58, 66.

[10]We have set forth our views on primary jurisdiction under the Securities Exchange Act more fully in our brief *amicus curiae* in *Gordon* v. *New York Stock Exch.*, No. 74-304, certiorari granted November 18, 1974, and are providing copies to counsel for the appellees.

refer this matter to it. *United States* v. *Western Pac. Ry.*, 352 U.S. 59, 69; see *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 353.

6. All appellees suggest in various ways that the relatively limited element of competition in the secondary brokerage and inter-dealer markets sought by the government's complaint would disturb order in and undermine the entire primary distribution system. In response we quote the Commission's observation in a related context:

> an exaggerated fear of disorderly distribution should not be permitted to form a pretext for avoiding the introduction of price competition which, while perhaps difficult and even unprofitable for particular funds and their underwriters, and certain dealers, would be to the benefit of investors and the [mutual] fund industry generally. [1974 Report 115.]

For the reasons stated in the Brief for the United States and this reply brief, the judgment of the district court should be reversed.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.

MARCH 1975.

DOJ-1975-03

(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

UNITED STATES *v.* NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

No. 73-1701. Argued March 17, 1975—Decided June 26, 1975

Section 22 (d) of the Investment Company Act of 1940 provides that "no dealer shall sell [mutual fund shares] to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus." Section 22 (f) authorizes mutual funds to impose restrictions on the negotiability and transferability of shares, provided they conform with the fund's registration statement and do not contravene any rules and regulations that the Securities and Exchange Commission (SEC) may prescribe in the interests of the holders of all of the outstanding securities. Section 2 (6) of that Act defines a "broker" as a person engaged in the business of effecting transactions in securities for the account of others, and § 2 (11) defines a "dealer" as a person regularly engaged in the business of buying and selling securities for his own account. The Maloney Act of 1938 (§ 15A of the Securities Exchange Act of 1934) supplements the SEC's regulation of over-the-counter markets by providing a system of cooperative self-regulation through voluntary associations of brokers and dealers. The Government brought this action against appellee National Association of Securities Dealers (NASD), certain mutual funds, mutual-fund underwriters, and broker-dealers, alleging that appellees, in violation of § 1 of the Sherman Act, combined and agreed to restrict the sale and fix the resale prices of mutual-fund shares in secondary market transactions between dealers, from an investor to a dealer, and between investors through brokered transactions, and sought to enjoin such agreements. Count I of the complaint charged a horizontal combination and conspiracy among NASD's members to prevent the growth of a secondary dealer market in

the purchase and sale of mutual-fund shares, the Government contending that such count was not to be read as direct attack on NASD rules, but on NASD's interpretations and appellees' extension of the rules so as to include a secondary market. Counts II–VIII alleged various vertical restrictions on secondary market activities. The District Court dismissed the complaint on the grounds that §§ 22 (d) and (f), when read in conjunction with the Maloney Act, afforded antitrust immunity from all of the challenged practices. It further determined that, apart from this statutory immunity, the pervasive regulatory scheme established by these statutes conferred an implied immunity from antitrust sanction. The court concluded that the § 22 (d) price maintenance mandate for sales by "dealers" applied to transactions in which a broker-dealer acts as statutory "broker" rather than a statutory "dealer," and thus that § 22 (d) governs transactions in which the broker-dealer acts as an agent for an investor as well as those in which he acts as a principal selling shares for his own account. *Held:*

1. Neither the language nor legislative history of § 22 (d) justifies extending the section's price maintenance mandate beyond its literal terms to encompass transactions by broker-dealers acting as statutory "brokers." Pp. 15–24.

(a) To construe § 22 (d) to cover all broker-dealer transactions would displace the antitrust laws by implication and also would impinge on the SEC's more flexible authority under § 22 (f). Implied antitrust immunity can be justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory system, and here no such showing has been made. P. 23.

(b) Such an expansion of § 22 (d)'s coverage would serve neither this Court's responsibility to reconcile the antitrust and regulatory statutes where feasible nor the Court's obligation to interpret the Investment Company Act in a manner most conducive to the effectuation of its goals. Pp. 23–24.

2. The vertical restrictions sought to be enjoined in Counts II–VIII are among the kinds of agreements authorized by § 22 (f), and hence such restrictions are immune from liability under the Sherman Act. Pp. 24–33.

(a) The restrictions on transferability and negotiability contemplated by § 22 (f) include restrictions on the distribution system for mutual-fund shares as well as limitations on the face of the shares themselves. To interpret the section as covering

Syllabus

only the latter would disserve the broad remedial function of the section, which, as a complement to § 22 (d)'s protection against disruptive price competition caused by dealers' "bootleg market" trading of mutual-fund shares, authorizes the funds and the SEC to deal more flexibly with other detrimental trading practices by imposing SEC-approved restrictions on transferability and negotiability. Pp. 25–29.

(b) To contend, as the Government does, that the SEC's exercise of regulatory authority has been insufficient to give rise to an implied immunity for agreements conforming with § 22 (f) misconceives the statute's intended operation. By its terms § 22 (f) authorizes properly disclosed restrictions unless they are inconsistent with SEC rules or regulations and thus authorizes funds to impose transferability or negotiability restrictions subject to SEC disapproval. Pp. 30–32

(c) The SEC's authority would be compromised if the agreements challenged in Counts II–VIII were deemed actionable under the Sherman Act. There can be no reconciliation of the SEC's authority under § 22 (f) to permit these and similar restrictive agreements with the Sherman Act's declaration that they are illegal *per se*. In this instance the antitrust laws must give way if the regulatory scheme established by the Investment Company Act is to work. Pp. 32–33.

3. The activities charged in Count I are neither required by § 22 (d) nor authorized under § 22 (f), and therefore cannot find antitrust shelter therein. The SEC's exercise of regulatory authority under the Maloney and Investment Company Acts is sufficiently pervasive, however, to confer implied immunity from antitrust liability for such activities. Pp. 33–38.

374 F. Supp. 95, affirmed.

POWELL, J., wrote the opinion of the Court, in which BURGER, C. J., and STEWART, BLACKMUN, and REHNQUIST, JJ., joined. WHITE, J., filed a dissenting opinion, in which DOUGLAS, BRENNAN, and MARSHALL, JJ., joined.

SUPREME COURT OF THE UNITED STATES

No. 73-1701

United States, Appellant, v. National Association of Securities Dealers, Inc., et al. — On Appeal from the United States District Court for the District of Columbia.

[June 26, 1975]

Opinion of the Court by MR. JUSTICE POWELL, announced by MR. JUSTICE BLACKMUN.

This appeal requires the Court to determine the extent to which the regulatory authority conferred upon the Securities and Exchange Commission by the Maloney Act and the Investment Company Act of 1940 displaces the strong antitrust policy embodied in § 1 of the Sherman Act. At issue is whether certain sales and distribution practices employed in marketing securities of open-end management companies, popularly referred to as "mutual funds," are immune from antitrust liability. We conclude that they are, and accordingly affirm the judgment of the District Court.

I

An "investment company" invests in the securities of other corporations and issues securities of its own.[1]

[1] The Investment Company Act of 1940 defines "investment company" to include any issuer of securities which

"(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

"(2) is engaged or proposes to engage in the business of issuing

Shares in an investment company thus represent proportionate interests in its investment portfolio, and their value fluctuates in relation to the changes in the value of the securities it owns. The most common form of investment company, the "open end" company or mutual fund, is required by law to redeem its securities on demand at a price approximating their proportionate share of the fund's net asset value at the time of redemption.[2] In order to avoid liquidation through redemption, mutual funds continuously issue and sell new shares. These features—continuous and unlimited distribution and compulsory redemption—are, as the Court recently recognized, "unique characteristic[s]" of this form of investment. *United States* v. *Cartwright*, 411 U. S. 546, 547 (1973).

The initial distribution of mutual-fund shares is conducted by a principal underwriter, often an affiliate of the fund, and by broker-dealers[3] who contract with that

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face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

"(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis." 15 U. S. C. § 80a-3 (a).

This broad definition is qualified, however, by a series of specific exemptions. See *id.*, §§ 80a-3 (b) and (c).

[2] See 15 U. S. C. § 80a-2 (a)(32); *id.*, § 80a-22 (e).

Management investment companies whose securities lack this redeemability feature are defined as "closed-end" companies, *id.*, § 80a-5, and their sales and distribution practices are regulated under § 23 of the Act. *Id.*, § 80a-23. Section 22, the provision under consideration in this appeal, governs the sales and distribution practices of "open-end" companies only.

[3] In this opinion we will use the term "broker-dealer" to refer generally to persons registered under the Securities Exchange Act of 1934, 15 U. S. C. § 78o *et seq.*, and authorized to effect trans-

underwriter to sell the securities to the public. The sales price commonly consists of two components, a sum calculated from the net asset value of the fund at the time of purchase, and a "load," a sales charge representing a fixed percentage of the net asset value. The load is divided between the principal underwriter and the broker-dealers, compensating them for their sales efforts.[4]

The distribution-redemption system constitutes the primary market in mutual-fund shares, the operation of which is not questioned in this litigation. The parties agree that § 22 (d) of the Investment Company Act requires broker-dealers to maintain a uniform price in sales in this primary market to all purchasers except the fund, its underwriters, and other dealers. And in view of this express requirement no question exists that antitrust immunity must be afforded these sales. This case focuses, rather, on the potential secondary market in mutual-fund shares.

Although a significant secondary market existed prior to enactment of the Investment Company Act, little presently remains. The United States agrees that the

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actions or induce the purchase or sale of securities pursuant to the authorization of that Act. We also will refer separately to "brokers" and "dealers" as defined by the Investment Company Act, see 15 U. S. C. §§ 80a-2 (a)(6) and (11), to describe the capacity in which a broker-dealer acts in a particular transaction.

[4] The Act defines "sales load" to be the difference between the public offering price and the portion of the sales proceeds that is invested or held for investment purposes by the issuer. *Id.*, § 80a-2 (a)(35). Most mutual funds charge this sales load in order to encourage vigorous sales efforts on the part of underwriters and broker-dealers. There are some funds that do not charge this additional sales fee. These "no load" funds generally sell directly to the investor without relying on the promotional and sales efforts of underwriters and broker-dealers. See SEC Report of the Division of Investment Management Regulation, Mutual Fund Distribution and § 22 (d) of the Investment Company Act of 1940, 112 (August 1974) (hereinafter 1974 Staff Report).

Act was designed to restrict most of secondary market trading, but nonetheless contends that certain industry practices have extended the statutory limitation beyond its proper boundaries. The complaint in this action alleges that the defendants, appellees herein, combined and agreed to restrict the sale and fix the resale prices of mutual-fund shares in secondary market transactions between dealers, from an investor to a dealer, and between investors through brokered transactions.[5] Named as defendants are the National Association of Securities Dealers (NASD),[6] and certain mutual funds,[7] mutual-fund underwriters,[8] and securities broker-dealers.[9]

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[5] Two additional private antitrust actions premised on similar theories were filed in the District Court and subsequently dismissed, *Haddad* v. *Crosby Corp.* and *Gross* v. *National Assn. of Securities Dealers, Inc.*, 374 F. Supp. 95. The Court of Appeals for the District of Columbia stayed those appeals to await the resolution of this case, and the petition of one of the parties for certiorari before judgment was denied, *Gross* v. *National Assn. of Securities Dealers, Inc.*, 419 U. S. 843 (1974).

Subsequent to the filing of the United States' complaint some 50 private suits purporting to be class actions under Fed. Rule Civ. Proc. 23 were filed in various district courts around the country. These cases were transferred to the United States District Court for the District of Columbia by the Judicial Panel on Multidistrict Litigation, *In re Mutual Fund Sales Antitrust Litigation*, Civil Action No. Misc. 103-73. See 374 F. Supp., at 97 n. 4. The District Court deferred determination whether the actions could be maintained as class actions under Rule 23 and additionally postponed discovery and other activity pending disposition of the motion to dismiss in this case. *Id.*, at 114.

[6] The National Association of Securities Dealers is registered under § 15A of the Securities Exchange Act of 1934, 15 U. S. C. § 78o-3, the so-called Maloney Act of 1938. The Maloney Act supplements the Securities and Exchange Commission's regulation of the over-the-counter markets by providing a system of cooperative self-regulation through voluntary associations of brokers and dealers. The Act provides that associations may register with the Commission

[*Footnotes 7, 8, and 9 are on p. 5*]

The United States charges that these agreements violate § 1 of the Sherman Act, 15 U. S. C. § 1,[10] and prays that they be enjoined under § 4 of that Act. *Id.*, § 4.

Count I charges a horizontal combination and conspiracy among the members of appellee NASD to prevent the growth of a secondary dealer market in the purchase and sale of mutual-fund shares. See n. 42,

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pursuant to specified terms and conditions, and authorizes them to promulgate rules designed to prevent fraudulent and manipulative practices; to promote equitable principles of trade; to safeguard against unreasonable profits and charges; and generally to protect investors and the public interest. *Id.*, § 78o–3 (b) (8). The Act also authorizes the SEC to exercise a significant oversight function over the rules and activities of the registered associations. See, *e. g.*, *id.*, §§ 78o–3 (b), (e), (h), (j), and (k). The NASD is presently the only association registered under this Act.

[7] The mutual funds named as defendants in this action are Massachusetts Investors Growth Stock Fund, Inc., Fidelity Fund, Inc., and Wellington Fund, Inc.

[8] The defendant underwriters include the Crosby Corporation, Vance Sanders & Co., and the Wellington Management Company.

[9] Named as defendant broker-dealers are the following: Merrill Lynch, Pierce, Fenner & Smith, Inc., Bache & Company, Inc., Reynolds Securities Corp., F. I. duPont, Glore Forgan, Inc., E. F. Hutton, Inc., Walston & Company, Inc., Dean Witter & Company, Inc., Paine, Webber, Jackson & Curtis, Inc., and Hornblower & Weeks-Hemphill, Noyes, Inc.

[10] Section 1 of the Sherman Act provides in pertinent part:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . .

. . . . .

"Every person who shall make any contract or engage in any combination or conspiracy declared by sections 1 to 7 of this title to be illegal shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

infra. Counts II–VIII, by contrast, allege various vertical restrictions on secondary market activities. In Counts II, IV, and VI the United States charges that the principal underwriters and broker-dealers entered into agreements that compel the maintenance of the public offering price in brokerage transactions of specified mutual-fund shares, and that prohibit interdealer transactions by allowing each broker-dealer to sell and purchase shares only to or from investors.[11] Count VIII alleges that the broker-dealers entered into other, similar contracts and combinations with numerous principal underwriters. Counts III, V, and VII allege violations on the part of the principal underwriters and the funds themselves. In Counts III and VII the various defendants are charged with entering into contracts requiring the restrictive underwriter-dealer agreements challenged

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[11] The violations alleged in Count II are typical of those charged in Counts IV and VI. In Count II, appellee Crosby, a principal underwriter of appellee Fidelity Fund, Inc., is charged with entering into contracts and combinations with appellee broker-dealers, the substantial terms of which are that

"(a) each broker/dealer must maintain the public offering price in any brokerage transaction in which it participates involving the purchase or sale of shares of the Fidelity Funds; and

"(b) each broker/dealer must sell shares of the Fidelity Funds only to investors or the fund and purchase such shares only from investors or the fund." App. 10–11.

Count VI, in addition to charging restrictive agreements similar to the above, alleged that appellee Wellington, a principal underwriter, agreed to act only as an agent of the appropriate mutual fund in all transactions with the broker-dealers. *Id.*, at 15.

The alleged effect of the restrictive agreement charged in ¶ (a) was to inhibit the growth and development of a brokerage market in mutual fund shares. The alleged effect of the restriction identified in ¶ (b), by contrast, was to inhibit interdealer transactions and thus to restrict the growth and development of a secondary dealer market. *Id.*, at 11.

in Counts II and VI. Count V charges that the agreement between one fund and its underwriter restricted the latter to serving as a principal for its own account in all transactions with the public, thereby prohibiting brokerage transactions in the fund's shares. App. 14.

After carefully examining the structure, purpose and history of the Investment Company Act, 15 U. S. C. § 80a–1 *et seq.*, and the Maloney Act, 15 U. S. C. § 78o–3, the District Court held that this statutory scheme was "incompatible with the maintenance of [an] antitrust action," 347 F. Supp., at 109, quoting *Silver* v. *New York Stock Exchange,* 373 U. S. 341, 358 (1963). The court concluded that §§ 22 (d) and (f) of the Investment Company Act, when read in conjunction with the Maloney Act, afford antitrust immunity for all of the practices here challenged. The court further held that apart from this explicit statutory immunity, the pervasive regulatory scheme established by these statutes confers an implied immunity from antitrust sanction in the "narrow area of distribution and sale of mutual fund shares." 374 F. Supp., at 114. The court accordingly dismissed the complaint, and the United States appealed to this Court.[12]

The position of the United States in this appeal can be summarized briefly. Noting that implied repeals of the antitrust laws are not favored, *see, e. g., United States* v. *Philadelphia National Bank,* 374 U. S. 321, 348 (1963), the United States urges that the antitrust immunity conferred by § 22 of the Investment Company Act should not extend beyond its precise terms, none of which, it maintains, requires or authorizes the practices

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[12] The Court noted probable jurisdiction on October 15, 1974. 419 U. S. 822. Accordingly, the recent amendments to the Expediting Act, 15 U. S. C. § 29, as amended by 88 Stat. 1709, do not affect our jurisdiction.

here challenged. The United States maintains, moreover, that the District Court expanded the parameters of the implied immunity doctrine beyond those recognized by decisions of this Court. In response, appellees advance all of the positions relied on by the District Court. They are joined by the Securities and Exchange Commission (SEC), which asserts as *amicus curiae* that the regulatory authority conferred upon it by § 22 (f) of the Investment Company Act displaces § 1 of the Sherman Act. The SEC contends, therefore, that the District Court properly dismissed Counts II–VIII but takes no position with respect to Count I.

II

A

The Investment Company Act of 1940 originated in congressional concern that the Securities Act of 1933, 15 U. S. C. § 77a *et seq.*, and the Securities Exchange Act of 1934, 15 U. S. C. § 78a *et seq.*, were inadequate to protect the purchasers of investment company securities. Thus, in § 30 of the Public Utility Holding Company Act, 15 U. S. C. § 79z–4, Congress directed the SEC to study the structures, practices and problems of investment companies with a view toward proposing further legislation. Four years of intensive scrutiny of the industry culminated in the publication of the Investment Trust Study and the recommendation of legislation to rectify the problems and abuses it identified. After extensive congressional consideration, the Investment Company Act of 1940 was adopted.

The Act vests in the SEC broad regulatory authority over the business practices of investment companies.[13]

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[13] For example, the Act requires companies to register with the SEC, 15 U. S. C. § 80a–8, see also, *id.*, § 80a–7. Companies also must register all securities they issue, see Securities Exchange Act of

We are concerned on this appeal with § 22 of the Act, *id.*, § 80a–22, which controls the sales and distribution of mutual-fund shares. The questions presented require us to determine whether § 22 (d) obligates appellees to engage in the practices challenged in Counts II–VIII and thus necessarily confers antitrust immunity for them. If not, we must determine whether such practices are authorized by § 22 (f) and, if so, whether they are immune from antitrust sanction. Resolution of these issues will be facilitated by examining the nature of the problems and abuses to which § 22 is addressed, a matter to which we now turn.

B

The most thorough description of the sales and distribution practices of mutual funds prior to passage of the Investment Company Act may be found in Part III of the Investment Trust Study.[14] That study, as Congress

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1933, 15 U. S. C. § 77a; Investment Company Act, 15 U. S. C. § 80a–24 (a), and must submit for SEC inspection copies of the sales literature they send to prospective investors. *Id.*, § 80a–24 (b). The Investment Company Act requires the submission and periodic updating of detailed financial reports and documentation and the semiannual transmission of reports containing similar information to the shareholders. *Id.*, § 80a–29. It also imposes controls and restrictions on the internal management of investment companies: establishing minimum capital requirements, *id.*, § 80a–14; limiting permissible methods for selecting directors, *id.*, § 80a–16; and establishing certain qualifications for persons seeking to affiliate with the companies, *id.*, § 80a–9. Finally, the Act imposes a number of controls on the internal practices of investment companies. For example, it requires a majority shareholder vote for certain fundamental business decisions, *id.*, § 30a–13, and limits certain dividend distributions, *id.*, § 80a–19. See generally, the Mutual Fund Industry: A Legal Survey, 44 Notre Dame Law. 732 (1969).

[14] SEC Report on Investment Trusts and Investment Companies, H. R. Doc. No. 279, 76th Cong., 1st Sess. (1940) (The Investment Trust Study). In this opinion we will refer primarily to Part III of

has recognized, see 15 U. S. C. § 80a-1, forms the initial basis for any evaluation of the Act.

Prior to 1940 the basic framework for the primary distribution of mutual-fund shares was similar to that existing today. The fund normally retained a principal underwriter to serve as a wholesaler of its shares. The principal underwriter in turn contracted with a number of broker-dealers to sell the fund's shares to the investing public.[15] The price of the shares was based on the fund's net asset value at the approximate time of sale, and a sales commission or load was added to that price.

Although prior to 1940 the primary distribution system for mutual-fund shares was similar to the present one, a number of conditions then existed that largely disappeared following passage of the Act. The most prominently discussed characteristic was the "two-price system," which encouraged an active secondary market under conditions that tolerated disruptive and discriminatory trading practices. The two-price system reflected the relationship between the commonly used method of computing the daily net asset value of mutual-fund shares and the manner in which the price for the following day was established. The net

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the Study, and all citations will be to that part unless otherwise designated. For additional discussion of the operations of open-end management investment companies, see 1974 Staff Report; SEC Report of the Staff on the Potential Economic Impact of a Repeal of § 22 (d) of the Investment Company Act of 1940 (November 1972); SEC Report on Public Policy Implications of Investment Company Growth, H. R. Rep. No. 2337, 89th Cong., 2d Sess. (1966) (hereinafter the 1966 SEC Report); SEC Report of the Special Study of Securities Markets, c. XI, Open-End Investment Companies (Mutual Funds), H. R. Doc. No. 95, pt. 4, 88th Cong., 1st Sess. (1963) (hereinafter 1963 Special Study).

[15] The broker-dealers operating within the primary distribution system are denominated "contract dealers" in the Study and will be so identified in this opinion.

asset value of mutual funds, which depends on the market quotations of the stocks in their investment portfolios, fluctuates constantly. Most funds computed their net asset values daily on the basis of the fund's portfolio value at the close of exchange trading, and that figure established the sales price that would go into effect at a specified hour on the following day. During this interim period two prices were known: the present day's trading price based on the portfolio value established the previous day; and the following day's price, which was based on the net asset value computed at the close of exchange trading on the present day. One aware of both prices could engage in "riskless trading" during this interim period. See Investment Trust Study, at 851–852.

The two-price system did not benefit the investing public generally. Some of the mutual funds did not explain the system thoroughly, and unsophisticated investors probably were unaware of its existence. See *id.*, at 867. Even investors who knew of the two-price system and understood its operation were rarely in a position to exploit it fully. It was possible, however, for a knowledgeable investor to purchase shares in a rising market at the current price with the advance information that the next day's price would be higher. He thus could be guaranteed an immediate appreciation in the market value of his investment,[16] although this advantage was obtained at the expense of the existing share-

[16] The Study indicates that mutual funds increasingly began to disclose more information about the existence and operation of the two-price system. See Investment Trust Study, at 867–868. And in some instances the funds encouraged broker-dealers to explain to potential incoming investors the immediate appreciation in investment value that could be obtained from the pricing system in the hope of encouraging the purchase of shares. *Id.*, at 854. See 1940 Senate Hearings, pt. 1, at 138.

holders, whose equity interests were diluted by a corresponding amount.[17] The load fee that was charged in the sale of mutual funds to the investing public made it difficult for these investors to realize the "paper gain" obtained in such trading. Because the daily fluctuation in net asset value rarely exceeded the load, public investors generally were unable to realize immediate profits from the two-price system by engaging in rapid in-and-out trading. But insiders, who often were able to purchase shares without paying the load, did not operate under this constraint. Thus insiders could, and sometimes did, purchase shares for immediate redemption at the appreciated value. See n. 24, *infra,* and sources cited therein.

The two-price system often afforded other advantages to underwriters and broker-dealers. In a falling market they could enhance profits by waiting to fill orders with shares purchased from the fund at the next day's anticipated lower price. In a similar fashion, in a rising market they could take a "long position" in mutual-fund shares by establishing an inventory in order to satisfy anticipated purchases with securities previously obtained at a lower price. *Id.,* at 854–855. In each case the investment company would receive the lower of the two prevailing prices for its shares, *id.,* at 854, and the equity interests of shareholders would suffer a corresponding dilution.

As a result, an active secondary market in mutual-fund shares existed. *Id.,* at 865–867. Principal underwriters and contract broker-dealers often maintained

[17] The existing shareholders' equity interests were diluted because the incoming investors bought into the fund at less than the actual value of the shares at the time of purchase. Moreover, SEC testimony indicated that this dilution could be substantial. In one instance the Commission calculated that the two-price system resulted in a loss to existing shareholders of one trust of some $133,000 in a single day *Id.,* at 139–140.

inventory positions established by purchasing shares through the primary distribution system and by buying from other dealers and retiring shareholders.[18] Additionally, a "bootleg market" sprang up, comprised of broker-dealers having no contractual relationship with the fund or its principal underwriter. These bootleg dealers purchased shares at a discount from contract dealers or bought them from retiring shareholders at a price slightly higher than the redemption price. Bootleg dealers would then offer the shares at a price slightly lower than that required in the primary distribution system, thus "initiating a small scale price war between retailers and tend[ing] generally to disrupt the established offering price." *Id.*, at 865.

Section 22 of the Investment Company Act of 1940 was enacted with these abuses in mind. Sections 22 (a) and (c) were designed to "eliminat[e] or reduc[e] as far as reasonably practicable any dilution of the value of other outstanding securities . . . or any other result of [the] purchase, redemption or sale [of mutual fund securities] which is unfair to holders of such other outstanding securities," 15 U. S. C. § 80a–22 (a). They authorize the NASD and the SEC to regulate certain pricing and trading practices in order to effectuate that goal.[19] Section 22 (b) authorizes registered securities

[18] Contract dealers trading from an inventory position often could obtain an additional profit from the sales load. When the dealer acted as an agent for the fund and traded from the primary distribution system, the dealer and the underwriter divided the load charge in accordance with the sales agreement. But the dealer could retain the full load when he filled the purchase order from an inventory position in shares purchased from retiring shareholders or other dealers. *Id.*, at 858–859.

[19] Sections 22 (a) and (c) reflect the same basic relationship between the SEC and the NASD that is established by the Maloney Act. See n. 6, *supra*. Section 22 (a) authorizes registered securities associations, in this case the NASD, to prescribe rules for the regulation of

associations and the SEC to prescribe the maximum sales commissions or loads that can be charged in connection with a primary distribution; and § 22 (e) protects the right of redemption by restricting mutual funds' power to suspend redemption or postpone the date of payment.

The issues presented in this litigation revolve around subsections (d) and (f) of § 22. Bearing in mind the history and purposes of the Investment Company Act, we now consider the effect of these subsections on the question of potential antitrust liability for the practices here challenged.

III

Section 22 (d) prohibits mutual funds from selling shares at other than the current public offering price to any person except either to or through a principal underwriter for distribution. It further commands that "no

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these matters. 15 U. S. C. § 80a-22 (a). The industry thus is afforded the initial opportunity to police its own practices. If, however, industry self-regulation proves insufficient, § 22 (c) authorizes the Commission to make rules and regulations "covering the same subject matter, and for the accomplishment of the same ends as are prescribed in subsection (a)," and proclaims that the SEC rules and regulations supersede any inconsistent rules of the registered securities association. *Id.*, § 80a-22 (c).

Shortly after enactment of the Investment Company Act the NASD proposed, and the SEC approved, a rule establishing twice-daily pricing. See *Proposed Amendment to the Rules of Fair Practice of the NASD, Inc.*, 9 S. E. C. 38 (1941). Twice-daily pricing reduced the time period in which persons could engage in riskless trading and correspondingly decreased the potential for dilution. The Commission subsequently provided full protection against the dilutive effects of riskless trading. In late 1968 it exercised its authority under § 22 (c) to adopt Rule 22c-1, which requires all funds to establish "forward pricing." Forward pricing eliminates the potential for riskless trading altogether. See *Adoption of Rule 22c-1*, Inv. Co. Act Rel. No. 5519 (1968), CCH Fed. Sec. L. Rep. ¶ 77,616; 17 CFR § 270.22c-1.

dealer shall sell [mutual fund shares] to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus." 15 U. S. S. § 80a–22 (d).[20] By its terms, § 22 (d) excepts interdealer sales from its price maintenance requirement. Accordingly, this section cannot be relied upon by appellees as justification for the restrictions imposed upon interdealer transactions. At issue, rather, is the narrower question whether the § 22 (d) price maintenance mandate for sales by "dealers" applies to transactions in which a broker-dealer acts as a statutory "broker" rather than a statutory "dealer." The District Court concluded that it does, and thus that § 22 (d) governs transactions in which the broker-dealer acts as an agent for an investor as well as those in which he acts as a principal selling shares for his own account.

A

The District Court's decision reflects an expansive view of § 22 (d). The Investment Company Act specifically defines "broker" and "dealer"[21] and uses the

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[20] This section provides in pertinent part:

"No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus." 15 U. S. C. § 80a–22 (d).

[21] The Investment Company Act defines a "dealer" to be:

"[A]ny person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his

terms distinctively throughout.[22] Appellees maintain, however, that the defintion of "dealer" is sufficiently broad to require price maintenance in brokerage transactions. In support of this position appellees assert that the critical elements of the dealer definition are that the term relates to a "person" rather than to a transaction and that the person must engage "regularly" in the sale and purchase of securities to qualify as a dealer. It is argued, therefore, that any person who purchases and sells securities with sufficient regularity to qualify as a statutory dealer is thereafter bound by all dealer restrictions, regardless of the nature of the particular transaction in question. We do not find this argument persuasive.

Appellees' reliance on the statutory reference to "person" in defining dealer adds little to the analysis, for the Act defines "broker," "investment banker," "issuer," "underwriter," and others to be "persons" as well. See *id.*, §§ 80a-2 (a)(6), (21), (22), & (40). In each instance, the

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own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U. S. C. § 80a-2 (a)(11). A "broker," by contrast, is defined to be:

"[A]ny person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." *Id.*, § 80a-2 (a)(6).

[22] Congress employed the term "broker" without reference to "dealer" in various sections of the Act. See *id.*, §§ 80a-3 (c)(2); 80a-10 (b)(1); 80a-17 (e)(1) and (2). In other instances, the Act refers to "dealer" without reference to "broker," see *id.*, §§ 80a-2 (a)(40); 80a-22 (c) and (d). And in some cases, including the very definition of the term "dealer" itself, see n. 21, *supra*, the Act refers to both "broker" and "dealer" in the same provision, see *id.*, §§ 80a-1 (b)(2); 80a-9 (a)(1) and (2); and 80a-30 (a). Finally, the Act in some cases refers to the more general term "broker-dealer," see *id.*, §§ 80a-22 (b)(1) and (2).

critical distinction relates to their transactional capacity. Moreover, we think that appellees reliance on the regularity requirement in the dealer definition places undue emphasis on that element at the expense of the remainder of the provision. On the face of the statute the most apparent distinction between a broker and a dealer is that the former effects transactions for the account of others and the latter buys and sells securities for his own account. We therefore cannot agree that the terms of the Act compel the conclusion that a broker-dealer acting in a brokerage capacity would be bound by the § 22 (d) dealer mandate. Indeed, the language of the Act suggests the opposite result.

Even if we assume, *arguendo*, that the statutory definition is ambiguous, we find nothing in the extensive contemporaneous legislative history of the Investment Company Act to justify interpreting § 22 (d) to encompass brokered transactions. That history is sparse,[23] and

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[23] The original Commission-sponsored bill considered in the initial hearings before the Senate Banking and Commerce Subcommittee, S. 3580, 76th Cong., 3d Sess. (1940), contained no provision resembling this subsection. Section 22 (d) first emerged in a compromise proposal advanced after a period of intensive consultation between the SEC and industry representatives that followed initial Senate hearings, see 1940 Senate Hearings, pt. 4, at 1105–1107, and the Commission subsequently has indicated that this provision was suggested by the industry. See *Midamerica Mutual Fund*, 41 S. E. C. 328, 331 (1963); 1966 Public Policy Study, at 219. Revised legislation reflecting this compromise was submitted, and further hearings were conducted in the Senate and the House. Both bills were reported favorably by their respective committees, S. Rep. No. 1775, 76th Cong., 3d Sess. (1940); H. R. Rep. No. 2639, 76th Cong., 3d Sess. (1940), and the House bill, with minor amendments not relevant to this appeal, was accepted by the Senate. 86 Cong. Rec. 10069–10071.

This history perhaps explains the dearth of discussion relating to § 22 (d). The majority of the Senate hearings were completed

suggests only that § 22 (d) was considered necessary to curb abuses that had arisen in the sales of securities to insiders as well.[24]

The prohibition against insider trading would seem adequately served by the first clause of § 22 (d), which prevents mutual funds from selling shares at other than the public offering price to any person except a principal underwriter or dealer. See n. 20, *supra.*[25] The further restriction on dealer sales bears little relation to insider trading, however, and logically would be thought to serve some other purpose. The obvious effect of the dealer prohibition is to shield the primary distribution system from the competitive impact of unrestricted dealer trading in the secondary markets, a concern that was reflected

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before this provision was advanced, and both the Senate and House hearings that followed provide relatively little illumination as to the intended purpose or scope of this subsection.

[24] Insider trading abuses were identified as a problem during the Senate hearings that preceded submission of the compromise bill containing § 22 (d), see 1940 Senate Hearings, pt. 2, at 526–527 and 660–661. At the close of the initial Senate hearings an industry representative suggested that the Act should contain a provision prohibiting sales at preferential terms to insiders and others. *Id.*, at 1057. The Commission and industry representatives thereafter met to seek a compromise on the various differences that had been identified in the Senate hearings, and the industry memorandum outlining the nature of the resultant agreement again indicated that a provision should be added to the Act to prohibit insider trading. See Framework of Proposed Investment Company Bill (Title I), Memorandum Embodying Suggestions Resulting from Conference Between Securities and Exchange Commission and Representatives of Investment Companies (May 13, 1940), printed in 1940 House Hearings, at 99.

[25] The insider trading prohibition is complimented by § 22 (g), which precludes issuance of mutual fund shares for services or property other than cash or securities. 15 U. S. C. § 80a–22 (g).

in the Study, see Investment Trust Study, at 865. The SEC perceives this to be one of the purposes of this provision.[26]

But concluding that protection of the primary distribution system is a purpose of § 22 (d) does little to resolve the question whether Congress intended to require strict price maintenance in *all* broker-dealer transactions with the investing public. By its terms, § 22 (d) protects only against the possibly disruptive effects of secondary dealer sales which, as statutorily defined, constituted the most active secondary market existing prior to the Act's passage. Nothing in the contemporary history suggests that Congress was equally concerned with possible disruption from investor transactions in outstanding shares conducted through statutory brokers.

Nor do we think that the history attending subsequent congressional consideration of the Act provides adequate support for appellees' contention that § 22 (d) requires strict price maintenance in all broker-dealer transactions in mutual-fund shares. To be sure, portions of the testi-

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[26] See *Adoption of Rule N-22-D-1*, Inv. Co. Act Rel. No. 2798, p. 1 (1958), CCH Fed. Sec. L. Rep. ¶ 76,625, p. 80,393; *Investors Diversified Services Inc.*, Inv. Co. Act Rel. No. 3015 (1960), CCH Fed. Sec. L. Rep. ¶ 76,699, p. 80,620; *In re Sideris*, Exch. Act Rel. No. 8816, p. 2 (1970); *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932, p. 4 (1972).

The SEC also has suggested that preventing discrimination among investors was one of the purposes of this provision. See, *e. g., In re Sideris, supra; Midamerica Mutual Fund, Inc.*, 41 S. E. C. 328, 331 (1963); *Adoption of Rule N22-D-1, supra.* But we do not think that brokerage transactions inevitably would foster the kind of investor discrimination sought to be remedied by this statute. All investors would be equally free to seek to engage in brokered transactions, and the possibility that the more sophisticated or fortuitous investor would profit from this market does not, by itself, bring this category of transactions within the purview of § 22 (d).

mony of SEC Chairman Cohen before the House Subcommittee on Commerce and Finance in 1967 suggested that the price maintenance requirement of § 22 (d) encompassed all broker-dealers, irrespective of how they obtained the traded shares,[27] and on other occasions the Chairman referred to sales by brokers when discussing mutual fund transactions.[28] Appellees also can point to congressional characterizations of § 22 (d) that suggest that some members of Congress understood the reach of that provision to be as broad as the District Court thought.[29]

Appellees maintain that this history indicates that Congress always intended § 22 (d) to control broker as well as dealer transactions, and that it re-enacted the

[27] Responding to inquiries concerning the relationship of § 22 (d) and the operation of state law, Chairman Cohen stated:

"The statute is unequivocal. No person, no matter where he gets it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer." 1967 House Hearings, pt. 2, at 711.

[28] *Id.*, pt. 1, at 53.

[29] Senator Sparkman, Chairman of the Senate Banking and Currency Committee which reported the 1970 amendments to the full Senate, stated on the floor of the Senate that § 22 (d) "now makes it a Federal crime for *anyone* to sell mutual fund shares at a price lower than that fixed by the fund's distributor." 115 Cong. Rec. 838 (1969) (emphasis added). Senator Magnuson reflected perhaps a similar view, stating that, as a result of § 22 (d) "mutual fund shares are *totally* insulated from price competition." 114 Cong. Rec. 23057 (1968) (emphasis added).

The testimony of some witnesses suggests that they shared this expansive view. See, *e. g.*, Hearings on S. 1659 before the Senate Committee on Banking and Currency, 90th Cong., 1st Sess., pt. 2, at 741 (1967) (hereinafter 1967 Senate Hearings) (testimony of Mr. Funston, President of the New York Stock Exchange); *id.*, pt. 1, at 348, 356 (testimony of Professor Samuelson); *id.*, p. 2, at 1064 (testimony of Professor Wallich).

amended § 22 with that purpose in mind. The District Court accepted this position, and it is not without some support in this historical record.[30] But impressive evidence to the contrary is found in the position consistently maintained by the SEC. Responding to an inquiry in 1941, the SEC General Counsel stated that § 22 (d) did not bar brokerage transactions in mutual fund shares:

> "In my opinion the term 'dealer,' as used in Section 22 (d), refers to the capacity in which a broker-dealer is acting in a particular transaction. It follows, therefore, that if a broker-dealer in a particular transaction is acting solely in the capacity of agent for a selling investor, or for both a selling investor and a purchasing investor, the sale may be made at a price other than the current offering price described in the prospectus.
>
> . . . . .
>
> "On the other hand, if a broker-dealer is acting for his own account in a transaction and as principal sells a redeemable security to an investor, the public offering price must be maintained, even though the sale is made through another broker who acts as agent for the seller, the investor, or both.
>
> "As Section 22 (d) itself states, the offering price is not required to be maintained in the case of sales

[30] We conclude, however, that the context of the post-enactment history of § 22 (d) limits the force of the statements relied upon by appellees. A broker-dealer can serve in either a broker or a dealer's capacity, and the distinction between the two functions is rather technical and precise. The parties are in general agreement that no significant number of brokered transactions, as statutorily defined, existed prior or subsequent to passage of the Act. In view of the care with which the statute defines these functions and the absence of focus on these distinctions in the statements in the subsequent consideration of § 22 (d), we think that the broader characterizations of that section must be viewed with some skepticism.

in which both the buyer and the seller are dealers acting as principals in the transactions." Inv. Co. Act. Rel. No. 78, March 4, 1941, 11 Fed. Reg. 10992 (1946).

This substantially contemporaneous interpretation of the Act has consistently been maintained in subsequent SEC opinions, see *Oxford, Co., Inc.*, 21 S. E. C. 681, 690 (1946); *Mutual Funds Advisory, Inc.*, Inv. Co. Act. Rel. No. 6932, at 3 (1972). The same position was asserted in a recent Staff Report, see 1974 Staff Report, at 105 n. 2, 107 n. 2, and 109 (1974), was relied on by the SEC in its subsequent decision to encourage limited price competition in brokered transactions,[31] and is advanced by it as *amicus curiae* in this Court. This consistent and longstanding interpretation by the agency charged with administration of the Act, while not controlling, is entitled considerable weight. See, *e. g., Saxbe* v. *Bustos*, 419 U. S. 65 (1974); *Investment Company Institute* v. *Camp*, 401

[31] Acting in accordance with the recommendations of the Staff Report, the SEC Chairman recently requested that the NASD amend its Rules of Fair Practice to prohibit agreements between underwriters and broker-dealers that preclude broker-dealers, acting as agents, "from matching orders to buy and sell fund shares in a secondary market at competitively determined prices and commission rates." Letter from Mr. Ray Garrett, Jr., Chairman of the SEC to Mr. Gordon S. Macklin, President of the NASD, November 22, 1974, printed in addendum to brief of appellees Bache & Co., *et al*, at 18. The Chairman further revealed the SEC's intention to exercise its regulatory authority under § 22 (f) to neutralize any adverse effects this market might have on the fund's primary distribution systems. *Id.*, at 19. As the Staff Report indicates, the Commission's exercise of regulatory authority is premised on its view that § 22 (d) does not require strict price maintenance in brokered transactions. See 1974 Staff Report, at 104. If § 22 (d) did control these transactions as well as "dealer" sales, the Commission's ability to encourage controlled competition in this market would be subject to question.

U. S. 617, 626–627 (1971); *Udall* v. *Tallman*, 380 U. S. 1, 16 (1965).

B

The substance of appellees' position is that the dealer prohibition of § 22 (d) should be interpreted in generic rather than statutory terms. The price maintenance requirement of that section accordingly would encompass all broker-dealer transactions with the investing public and would shelter them from antitrust sanction. But such an expansion of § 22 (d) beyond its terms would not only displace the antitrust laws by implication; it also would impinge seriously on the SEC's more flexible regulatory authority under § 22 (f).[32]

Implied antitrust immunity is not favored, and can be justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory system. See, *e. g.*, *United States* v. *Philadelphia National Bank*, 374 U. S. 321, 348 (1963); *United States* v. *Borden Co.*, 308 U. S. 188, 197–206 (1939). We think no such showing has been made. Moreover, in addition to satisfying our responsibility to reconcile the antitrust and regulatory statutes where feasible, *Silver* v. *New York Stock Exchange*, 373 U. S. 341, 356–357 (1963), we must interpret the Investment Company Act

[32] The Department of Justice previously suggested a manner in which its interpretation of § 22 (d) could be reconciled with the Commission's exercise of regulatory authority over brokered transactions. Addressing the question of possible repeal of § 22 (d), the Justice Department suggested that rather than continue to wait for congressional repeal, the Commission should eliminate the adverse effects of price maintenance by freeing all transactions from the § 22 (d) mandate through the exercise of its § 6 (c) power of exemption, 15 U. S. C. § 80a–6 (c). *Id.*, at 70. This presumably would leave the SEC free to regulate transactions through the exercise of the powers conferred to it by other provisions of the Act. We need not consider the validity of the Justice Department's broad interpretation of the SEC's power of exemption, for even assuming it to be correct our analysis would not be affected.

in a manner most conductive to the effectuation of its goals. We conclude that appellee's interpretation of § 22 (d) serves neither purpose, and cannot be justified by the language or history of that section.

We therefore hold that the price maintenance mandate of § 22 (d) cannot be stretched beyond its literal terms to encompass transactions by broker-dealers acting as statutory "brokers." Congress defined the limitations for the mandatory price maintenance requirement of the Investment Company Act. "We are not only bound by those limitations but we are bound to construe them strictly, since resale price maintenance is a privilege restrictive of a free economy." *United States* v. *McKesson & Robbins*, 351 U. S. 305, 316 (1956). Accordingly, we hold that the District Court erred in relying on § 22 (d) in determining that the activities here questioned are immune from antitrust liability.

IV

Our determination that the restrictions on the secondary market are not immunized by § 22 (d) does not end the inquiry, for the District Court also found them sheltered from antitrust liability by § 22 (f). Appellees, joined by the SEC, defend this ruling and urge that it requires dismissal of the challenge to the vertical restrictions sought to be enjoined in Counts II–VIII.

Section 22 (f) authorizes mutual funds to impose restrictions on the negotiability and transferability of their shares, provided they conform with the fund's registration statement and do not contravene any rules and regulations the Commission may prescribe in the interests of the holders of all of the outstanding securities.[33] Appellant does not contend that the vertical

[33] Section 22 (f) of the Act, 15 U. S. C. § 80a–22 (f), provides: "No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in

restrictions are not disclosed in the registration statements of the funds in question. Nor does it assert that the agreements imposing such restrictions violate Commission rules and regulations. Indeed, it could not do so, because to date the SEC has prescribed no such standards. Instead appellant maintains that the contractual restrictions do not come within the meaning of the Act, asserting that § 22 (f) does not authorize the imposition of restraints on the distribution system rather than on the shares themselves. Appellant thus apparently urges that the only limitations contemplated by this section are those that appear on the face of the certificate itself. Appellant also urges that the SEC's unexercised power to prescribe rules and regulations is insufficient to create repugnancy between its regulatory authority and the antitrust laws.

Our examination of the language and history of § 22 (f) persuades us, however, that the agreements challenged in Counts II–VIII are among the kinds of restrictions Congress contemplated when it enacted that section. And this conclusion necessarily leads to a determination that they are immune from liability under the Sherman Act, for we see no way to reconcile the Commission's power to authorize these restrictions with the competing mandate of the antitrust laws.

A

Unlike § 22 (d), § 22 (f) originated in the Commission-sponsored bill considered in the Senate subcommittee hearings that preceded introduction of the compromise proposal later enacted into law. The Commission-

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conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company."

sponsored provision authorized the SEC to promulgate rules, regulations or orders prohibiting restrictions on the transferability or negotiability of mutual fund shares, S. 3580, § 22 (d)(2), 76th Cong., 3d Sess. (1940).[34] Commission testimony indicates that it considered this authority necessary to allow regulatory control of industry measures designed to deal with the disruptive effects of "bootleg market" trading and with other detrimental trading practices identified in the Investment Trust Study.[35]

[34] Section 22 (d) of the original bill, S. 3580, 76th Cong., 3d Sess. (1940), provided, in pertinent part:

"The Commission is authorized, by rules and regulations or order in the public interest or for the protection of investors, to prohibit—

. . . . .

"(2) restrictions upon the transferability of negotiability of any redeemable security of which any registered investment company is the issuer."

[35] Testifying before the Senate Subcommittee, an SEC spokesman stated:

"Now coming to subparagraph (2) of (d), it just says that the Commission shall have the right to make rules and regulations with respect to any restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.

"There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. It presents a whole problem which they call the bootleg market. What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company.

. . . . .

"If the committee wants the provision, we shall recommend what, on the basis of our experience up to the present time, it ought to be; but we think subjects like that ought to be a matter of rules and regulations." 1940 Senate Hearings, pt. 1, at 292–293.

The Study indicates, moreover, that a number of funds had begun to deal with these problems prior to passage of the Act. And while their methods may have included the imposition of restrictive legends on the face of the certificate, see n. 35, *supra,* they were by no means confined to such narrow limits. A number of funds imposed controls on the activities of their principal underwriters, see Investment Trust Study, at 868–869; and in some instances the funds required the underwriters to impose similar restrictions on the dealers, see *id.,* at 869, or entered into these restrictive agreements with the dealers themselves, *id.,* at 870–871.

In view of the history of the Investment Company Act, we find no justification for limiting the range of possible transfer restrictions to those that appear on the face of the certificate. The bootleg market was primarily a problem of the distribution system, and bootleg dealers found a source of supply in the contract-dealers as well as in retiring shareholders. See *id.,* at 865. Moreover, the Study indicates that part of the bootleg distribution system consisted of "trading firms" that served as wholesalers of mutual-fund securities in much the same fashion as the principal underwriters. These trading firms primarily purchased and sold shares to and from other dealers, *id.,* pt. II, at 327, frequently offering them at a price slightly lower than the discounted rate charged to dealers in the primary distribution system. *Id.,* at 327–328. Thus trading firms not only helped supply the bootleg dealers whose sales undercut those of the contract-dealers, they competed with the principal underwriters by offering a source for lower cost shares that inevitably discouraged participation in the primary distribution system. See *id.,* at 328 n. 85.

The bootleg market was a complex phenomenon whose

principal origins lay in the distribution system itself. In view of this history, limitation of the industry's ability, subject of course to SEC regulation, to reach these problems at their source would constitute an inappropriate contraction of the remedial function of the statute.[38] Indeed, in view of the role of trading firms and interdealer transactions in the maintenance of the bootleg market, the narrow interpretation of § 22 (f) urged by appellant would seem to afford inadequate authority to deal with the problem.

Together, §§ 22 (d) and 22 (f) protect the primary distribution system for mutual-fund securities. Section 22 (d), by eliminating price competition in dealer sales, inhibits the most disruptive factor in the pre-1940's mutual market and thus assures the maintenance of a viable sales system. Section 22 (f) compliments this protection by authorizing the funds and the SEC to deal more flexibly with other detrimental trading practices by imposing SEC-approved restrictions on transferability and negotiability. Appellant's limiting interpretation of § 22 (f) compromises this flexible mandate, and cannot be accepted.

We find support for our interpretation of § 22 (f) in the views expressed by the SEC shortly after the passage of the Act. Rule 26 (j)(2), proposed by NASD to curb abuses identified in the Study and the congressional hearings, provided limitations on underwriter

[38] Neither are we convinced of the necessity to limit negotiability or transferability restrictions to those appearing on the face of the certificate in order to assure their adequate disclosure to investors. Section 24 of the Act requires that mutual funds submit for SEC inspection copies of all sales literature that they send to prospective investors. 15 U. S. C. § 80a-24 (b). The Commission is therefore fully apprised as to the nature and sufficiency of the disclosure of these restrictions and can, if necessary, require supplementation of the information provided investors.

sales and redemptions to or from dealers who are not parties to sales agreements. In commenting on this proposed rule, the SEC characterized it as a "restriction on the transferability of securities," and specifically averted to its power to regulate such restrictions under 22 (f). *National Association of Securities Dealers*, 9 S. E. C. 38, 44–45 and n. 10 (1941). As indicated above, see *supra*, at 22, and sources there cited, this contemporaneous interpretation by the responsible agency is entitled to considerable weight. We therefore conclude that the restrictions on transferability and negotiability contemplated by § 22 (f) include restrictions on the distribution system for mutual-fund shares as well as limitations on the face of the shares themselves. The narrower interpretation of this provision advanced by appellant would disserve the broad remedial function of the statute.[37]

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[37] Neither do we agree with appellant's suggestion that § 22 (f) does not authorize restrictions in contracts between underwriters and dealers in which the fund is not a party. We note, preliminarily, that this position would not save Counts III, V, and VII from dismissal, since they relate to restrictions on underwriter conduct that are imposed by the fund. Even under the most technical reading of the statute these restrictions are "fund-imposed." Moreover, it further appears from the complaint that the agreement challenged in Count II is required by the fund-underwriter agreement challenged in Count III and thus also is "fund-imposed" in any but the most literal sense. More importantly, however, we think that appellant's position fails to recognize the relationship between the various participants in the distribution chain. As the history of the Investment Company Act recognizes, the relationship between the fund and its principal underwriter traditionally has been a close one. Sections 15 (b) and (c) reflect this fact, requiring, in effect, that funds establish written contracts with the underwriter that must be approved by a majority of the fund's disinterested directors and cannot remain in force for more than two years. 15 U. S. C. §§ 80a–15 (b) and (c). And NASD Rule 26 (c), in effect since 1941, requires that principal underwriters enter into

Appellant's additional contention that the SEC's exercise of regulatory authority has been insufficient to give rise to an implied immunity for agreements conforming with § 22 (f) misconceives the intended operation of the statute. By its terms, § 22 (f) authorizes properly disclosed restrictions unless they are inconsistent with SEC rules or regulations. The provision thus authorizes funds to impose transferability or negotiability restrictions, subject to Commission disapproval. In view of the evolution of this provision, there can be no doubt that this is precisely what Congress intended.

Section 22 (f) as originally introduced would have authorized the SEC to promulgate rules, regulations or orders prohibiting restrictions on the redeemability or transferability of mutual-fund shares. Congressional consideration of that provision raised some question whether existing restrictions on transferability and negotiability would remain valid unless specifically disapproved by the SEC.[38] The compromise provision, which subsequently was enacted into law, eliminated this uncertainty, however, and manifested a more positive attitude toward self-regulation.

Thus § 22 (f) specifically recognizes that mutual funds can impose such restrictions on the distribution system provided they are disclosed in the registration statement and conform to any rules and regulations that the SEC might adopt. In addition, § 22 (f) alters the focus of Commission scrutiny. Whereas the original provision allowed the SEC to make rules that serve "the public interest and . . . the protection of investors,"

agreements with the dealers who distribute the fund's securities. See *National Association of Securities Dealers*, 9 S. E. C. 38, 44, 48 (1941). In view of these requirements, and the broad remedial purpose of § 22 (f), we think that the underwriter-dealer agreements challenged in this complaint also must be regarded as fund-imposed within the contemplation of the statute.

[38] See 1940 Senate Hearings, pt. 1, at 293.

S. 3580, § 22 (d)(2), *supra*, § 22 (f) as enacted limits the Commission's rulemaking authority to the protection of the "interests of the holders of all of the outstanding securities of such investment company." 15 U. S. C. § 80a–22 (f). Viewed in this historical context, the statute reflects a clear congressional determination that, subject to Commission oversight, mutual funds should be allowed to retain the initiative in dealing with the potentially adverse effects of disruptive trading practices.

The Commission repeatedly has recognized the role of private agreements in the control of trading practices in the mutual fund industry. For example, in *First Multifund of America, Inc.*, Inv. Co. Act Rel. No. 6700 (1971), F. Sec. L. Rep. ¶ 78,209, at 80,602, it looked to restrictive agreements similar to those challenged in this litigation to ascertain an investment advisor's capacity in a particular transaction. At no point did it intimate that those agreements were not legitimate.[39] Likewise, Commission reports repeatedly have acknowledged the significant role that private agreements have played in restricting the growth of a secondary market in mutual-fund shares.[40] Until recently the Commission has al-

[39] Commissioner Loomis, dissenting from an SEC determination that an applicant lacked standing to seek an exemption from §§ 17 (a)(1) and 22 (d) of the Act, stated,

"I would conclude that applicant is a dealer in its relationship with the fund underwriter because to do otherwise would require us to ignore or nullify the perfectly lawful requirement in the dealer agreements that applicant act as a dealer. . . . [I] do not know of anything unlawful about the generally accepted form of dealer agreement used in the investment company industry." *Mutual Funds Advisory, Inc.*, Inv. Co. Act. Rel. No. 6932, at 7 (1972) (dissenting opinion).

While the majority disagreed with Commissioner Loomis' assessment of the facts of the case, it did not question his approval of the mentioned dealer agreement.

[40] See 1963 Special Study, at 98; 1974 Staff Report, at 104–106.

lowed the industry to control the secondary market through contractual restrictions duly filed and publicly disclosed. Even the SEC's recently expressed intention to introduce an element of competition in brokered transactions reflects measured caution as to the possibly adverse impact of a totally unregulated and restrained brokerage market on the primary distribution system. See n. 31, *supra.* The Commission's acceptance of fund-initiated restrictions for more than three decades hardly represents abdication of its regulatory responsibilities. Rather, we think it manifests an informed administrative judgment that the contractual restrictions employed by the funds to protect their shareholders were appropriate means for combatting the problems of the industry. The SEC's election not to initiate restrictive rules or regulations is precisely the kind of administrative oversight of private practices that Congress contemplated when it enacted § 22 (f).

We conclude, therefore, that the vertical restrictions sought to be enjoined in Counts II–VIII are among the kinds of agreements authorized § 22 (f) of the Investment Company Act.

B

The agreements questioned by the United States restrict the terms under which the appellee underwriters and broker-dealers may trade in shares of mutual funds. Such restrictions, affecting resale price maintenance and concerted refusals to deal, normally would constitute *per se* violations of § 1 of the Sherman Act. See, *e. g., Klor, Inc.* v. *Broadway-Hale Stores, Inc.,* 359 U. S. 207, 211–213 (1959); *Fashion Originators' Guild of America, Inc.* v. *Federal Trade Commission,* 312 U. S. 457, 465–468 (1941). Here, however, Congress has made a judgment that these restrictions on competition might be necessitated by the unique problems of the mutual fund in-

dustry, and has vested in the SEC final authority to determine whether and to what extent they should be tolerated "in the interests of the holders of all the outstanding securities" of mutual funds. 15 U. S. C. § 80a-22 (f).

The SEC, the federal agency responsible for regulating the conduct of the mutual-fund industry, urges that its authority will be compromised seriously if these agreements are deemed actionable under the Sherman Act.[41] We agree. There can be no reconciliation of its authority under § 22 (f) to permit these and similar restrictive agreements with the Sherman Act's declaration that they are illegal *per se*. In this instance the antitrust laws must give way if the regulatory scheme established by the Investment Company Act is to work. *Silver* v. *New York Stock Exchange, supra*. We conclude, therefore, that such agreements are not actionable under the Sherman Act, and that the District Court properly dismissed Counts II–VIII.

V

It remains to be determined whether the District Court properly dismissed Count I of appellant's complaint, which charged activities allegedly constituting a horizontal conspiracy between the NASD and its members to "prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares." App. 9.

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[41] In its brief to this Court, the SEC maintains:

"It would nullify the effect of this grant of regulatory authority to the Commission [under § 22 (f)] for this Court to hold that a district court may apply antitrust principles to conduct like that alleged in Counts II through VIII, when the expert body designated and empowered by Congress to regulate and supervise that conduct has not deemed it appropriate to prohibit the conduct." Brief of the Securities and Exchange Commission as *Amicus Curiae*, at 54.

The precise nature of the allegations of the complaint are obscured by subsequent concessions made by appellant to the District Court and reiterated here. It is clear, however, that Count I alleges activities that are neither required by § 22 (d) nor authorized under § 22 (f). And since they cannot find antitrust shelter in these provisions of the Investment Company Act, the question presented is whether the SEC's exercise of regulatory authority under this statute and the Maloney Act is sufficiently pervasive to confer an implied immunity. We hold that it is, and accordingly affirm the District Court's dismissal of this portion of the complaint.

Count I originally appeared to be a general attack on the NASD's role in encouraging the restrictions on secondary market activities challenged in the remainder of appellant's complaint. The acts charged in Count I focused in large part on NASD rules, and on information distributed by that association to its members.[42] Subse-

[42] The complaint averred that, in effectuating the conspiracy to restrain the growth of a secondary market in mutual-fund shares, the NASD, its members, and more particularly the other named defendants,

"(a) established and maintained rules which inhibited the development of a secondary dealer market and a brokerage market in mutual fund shares;

"(b) established and maintained rules which induced broker/dealers to enter into sales agreements with principal underwriters, with knowledge that sales agreements contained restrictive provisions which inhibited the development of a secondary dealer market and brokerage market in mutual fund shares;

"(c) induced member principal underwriters to include restrictive provisions in their sales agreements;

"(d) discouraged persons who made inquiry about the legality of a brokerage market from participating in a brokerage market and distributed misleading information to its members concerning the legality of a brokerage market in mutual fund shares; and

"(e) suppressed market quotations for the secondary dealer market." App. 9.

quently appellant advised the District Court that its complaint was not to be read as a direct attack on NASD rules, however, and it repeated that position before this Court.[43] Appellant now contends that its complaint should be interpreted as a challenge to various unofficial NASD interpretations and to appellees' extension of the rules in a manner that inhibit a secondary market.

In view of the scope of the SEC's regulatory authority over the activities of the NASD, appellant's decision to withdraw from direct attack on the association's rules was prudent. The SEC's supervisory authority over the NASD is extensive. Not only does the Maloney Act require the SEC to determine whether an association

[43] Appellant first indicated abandonment of its attack on the NASD rules during oral argument of appellees' motion to dismiss. See App. 328–332. Notwithstanding clauses (a) and (b) of paragraph 17 of the complaint, see n. 42, *supra*, appellant's counsel stated that it did not intend to challenge any NASD rule, app. 330. Counsel ambiguously suggested, however, that the members' compliance with those rules had aided and abetted alleged the conspiracy, *id.*, at 332, and stated that informal and secret activities of the association likewise had tended to inhibit growth of the secondary market, *id.*, at 330. Thereafter, in response to the District Court's invitation to join in the litigation as *amicus curiae*, the SEC expressed its concern that the action might involve an attack on NASD rules, a matter "over which the Commission is granted exclusive jurisdiction by Section 15A of the Securities Exchange Act of 1934, 15 U. S. C. § 78o–3 *et seq.* (the Maloney Act)." Letter from Mr. Lawrence E. Nerheim, General Counsel of the SEC to the District Court. App. 323. Appellant thereafter informed the court that the issues it sought to raise did not represent "an attack upon NASD Rules as such" but rather "aimed at an over-all course of conduct engaged in by the NASD and its members going beyond the NASD's rule-making authority." Letter from Mr. Bruce B. Wilson, Acting Asst. Attorney General for the Antitrust Division to the District Court. App. 327. It maintains the same position in this Court. See Brief for the United States, at 51 n. 47.

satisfies the strict statutory requirements of that Act and thus qualifies to engage in supervised regulation of the trading activities of its membership, 15 U. S. C. § 78o–3 (b), it requires registered associations thereafter to submit for Commission approval any proposed rule changes, *id.*, § 78o–3 (j). The Maloney Act additionally authorizes the SEC to request changes in or supplementation of association rules, a power that recently has been exercised with respect to some of the precise conduct questioned in this litigation, see n. 31, *supra*. If such a request is not complied with, the SEC may order such changes itself. *Id.*, § 78o–3 (k)(2).

The SEC, in its exercise of authority over association rules and practices, is charged with protection of the public interest as well as the interests of shareholders, see, *e. g.*, 15 U. S. C. §§ 78o–3 (a)(1), (b)(3), (c), and it repeatedly has indicated that it weighs competitive concerns in the exercise of its continued supervisory responsibility. See, *e. g.*, *In re Nat. Assn. of Securities Dealers, Inc.*, 18 S. E. C. 424, 236, 486–486–487 (1945); *Proposed Amendment to The Rules of Fair Practice of Nat. Assn. of Securities Dealers, Inc.*, 9 S. E. C. 38, 43–46 (1941); see also 1974 Staff Report, at 105, 109. As the Court previously has recognized, *United States* v. *Socony-Vacuum Oil Co.*, 310 U. S. 150, 227 n. 60 (1940), the investiture of such pervasive supervisory authority in the SEC suggests that Congress intended to lift the ban of the Sherman Act from association activities approved by the SEC.

We further conclude that appellant's attack on NASD interpretations of those rules cannot be maintained under the Sherman Act, for we see no meaningful distinction between the association's rules and the manner in which it construes and implements them. Each is equally a subject of SEC oversight.

Finally, we hold that appellant's additional challenges to the alleged activities of the membership of the NASD designed to encourage the kinds of restraints averred in Counts II–VIII likewise are precluded by the regulatory authority vested in the SEC by the Maloney and Investment Company Acts. It should be noted that appellant does not contend that appellees' activities have had the purpose or effect of restraining competition among the various funds.[44] Instead, appellant urges in Count I that appellees' alleged conspiracy was designed to encourage the suppression of intrafund secondary market activities, precisely the restriction that the SEC consistently has approved pursuant to § 22 (f) for nearly 35 years. This close relationship is fatal to appellant's complaint, as the Commission's regulatory approval of the restrictive agreements challenged in Counts II–VIII cannot be reconciled with appellant's attack on the ancillary activities averred in Count I. And this conclusion applies with equal force now that the SEC has determined to introduce a controlled measure of competition into the secondary market.

There can be little question that the broad regulatory authority conferred upon the SEC by the Maloney and Investment Company Acts enables it to monitor the activities questioned in Count I, and the history of Commission regulations suggests no laxness in the exercise of this authority.[45] To the extent that any of appellees'

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[44] Indeed, it appears that vigorous inter-brand competition exists in the mutual-fund industry—between the load funds themselves, between load and no-load funds, between open and closed-end companies, and between all of these investment forms and other investments. See 1974 Staff Report, at 20 *et seq.*

[45] As SEC Chairman Garrett observed in his letter submitting the 1974 Staff Report for congressional consideration, "No issuer of securities is subject to more detailed regulation than a mutual fund." Letter from Ray Garrett, Jr., Chairman, Securities and

ancillary activities frustrate the SEC's regulatory objectives it has ample authority to eliminate them.[46]

Here implied repeal of the antitrust laws is "necessary to make the [regulatory scheme] work." *Silver* v. *New York Stock Exchange, supra.* In generally similar situations, we have implied immunity in particular and discrete instances to assure that the federal agency entrusted with regulation in the public interest could carry out that responsibility free from the disruption of conflicting judgments that might be voiced by courts exercising jurisdiction under the antitrust laws. See *Hughes Tool Co.* v. *Trans World Airlines,* 409 U. S. 363 (1973); *Pan American World Airways, Inc.* v. *United States,* 371 U. S. 296 (1963). In this instance, maintenance of an antitrust action for activities so directly related to the SEC's responsibilities poses a substantial danger that appellees would be subjected to duplicative and inconsistent standards. This is hardly a result that Congress would have mandated. We therefore hold that with respect to the activities challenged in Count I of the complaint, the Sherman Act has been displaced by the pervasive regulatory scheme established by the Maloney and Investment Company Acts.

Affirmed.

Exchange Commission to the Honorable John Sparkman, Chairman of the Committee on Banking, Housing, and Urban Affairs, United States Senate (Nov. 4, 1974), contained in 1974 Staff Report, at v.

[46] The Commission can, for example, require amendment of the NASD rules regulating the conduct of its membership, see 15 U. S. C. § 78o-3 (k)(2), or exercise the more general rulemaking power conferred by § 38 (a) of the Investment Company Act, 15 U. S. C. § 80a-38 (a), to contain any of the challenged activities that might in any way frustrate its regulation of the restrictions it authorizes under § 22 (f).

SUPREME COURT OF THE UNITED STATES

No. 73–1701

United States, Appellant, *v.* National Association of Securities Dealers, Inc., et al.	On Appeal from the United States District Court for the District of Columbia.

[June 26, 1975]

MR. JUSTICE WHITE, with whom MR. JUSTICE DOUGLAS, MR. JUSTICE BRENNAN, and MR. JUSTICE MARSHALL join, dissenting.

The majority repeats the principle so often applied by this Court that "[i]mplied antitrust immunity is not favored, and can be justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory system." *Ante,* at 23. That fundamental rule, though invoked again and again in our decisions, retained its vitality because in the many instances of its evocation it was given life and meaning by a close analysis of the legislation and facts involved in the particular case, an analysis inspired by the "felt indispensable role of antitrust policy in the maintenance of a free economy . . . ." *United States* v. *Philadelphia National Bank,* 374 U. S. 321, 348 (1963). Absent that inspiration the principle becomes an archaism at best, and no longer reflects the tense interplay of differing and at times conflicting public policies.

Although I do not disagree with much of the Court's opinion in its construction of §§ 22 (d) and 22 (f) of the Investment Company Act, its ultimate holding, which in contrast to the earlier portions of its opinion is devoid of detailed discussion of the applicable law, I find unacceptable. Under that holding, in light of the context

of this case, implied antitrust immunity becomes the rule where a regulatory agency has authority to approve business conduct whether or not the agency is directed to consider antitrust factors in making its regulatory decisions and whether or not there is other evidence that Congress intended to displace judicial with administrative antitrust enforcement.

I

If Congress itself expressly permits or directs particular private conduct that would otherwise violate the antitrust laws, it can be safely assumed that Congress has made the necessary policy choices and preferred to permit rather than to prevent the acts in question. There is no dispute in this case, for example, that compliance with § 22 (d)'s requirement that open-end funds and dealers sell at the public offering price is not subject to attack under the antitrust laws.

It also happens that in subjecting areas of commercial activity to regulation, Congress frequently authorizes a regulatory agency to approve certain kinds of transactions if they conform to the appropriate regulatory standard such as the "public interest" or the "public convenience and necessity" and correspondingly provides that, when approved, those transactions will be immune from attack under the antitrust laws. Section 414 of the Federal Aviation Act, 49 U. S. C. § 1384, for example provides that any person affected by an order issued under §§ 408, 409, or 412 of that Act, 49 U. S. C. §§ 1378, 1379, 1382, is "relieved from the operations of the 'antitrust laws,'" including the Sherman Act, "insofar as may be necessary to enable such person to do anything authorized, approved, or required by such order." *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U. S. 363 (1973), thus involved acts and transactions expressly immunized from antitrust scrutiny. Section 5 (11) of the

Interstate Commerce Act, 49 U. S. C. § 5 (11), similarly provides that carriers and their employees participating in a transaction approved or authorized under § 5 "shall be and they are relieved from the operation of the antitrust laws . . . ." Also, the Clayton Act itself provides that § 7's prohibitions will not apply to transactions duly consumated pursuant to authority given by certain named agencies under any statutory provisions vesting power in those agencies. 15 U. S. C. § 18.

The courts have, of course, recognized express exemptions such as these; but the invariable rules has been "that exemptions from antitrust laws are strictly construed," *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U. S. 726, 733 (1973), and that exemption will not be implied beyond that given by the letter of the law. In *Seatrain* the Maritime Commission was authorized by statute to approve and immunize from antitrust challenge seven categories of agreements between shipping companies, including agreements "controlling, regulating, preventing, or destroying competition." The Court, construing narrowly the category arguably embracing the merger agreement under consideration, held that merger agreements between shipping companies were not subject to approval by the Commission and consequently were not entitled to exemption under the antitrust laws.

Absent express immunization or its equivalent, private business arrangements are not exempt from the antitrust laws merely because Congress has empowered an agency to authorize the very conduct which is later challenged in court under the antitrust laws. Where the regulatory standard is the "public interest," or something similar, there is no reason whatsoever to conclude that Congress intended the strong policy of the antitrust laws to be displaced or to be ignored in determining the public interest and in approving or disapproving the questioned

conduct. This has been the consistent position of this Court. In *United States* v. *Radio Corporation of America,* 358 U. S. 334 (1959), the approval of the Federal Communications Commission of an exchange of television stations was sought as required by statute, The Commission approved the exchange, finding, in accordance with the statutory standard, that the public interest, convenience, and necessity would be served. The United States brought an antitrust action to require divestiture. It was urged in defense that the Commission had been empowered to consider and adjudicate antitrust issues and that its approval immunized the transaction. The Court rejected the defense, Mr. Justice Harlan concurring in the judgment and summarizing the Court's holding as follows:

> "[T]hat a Commission determination of 'public interest, convenience and necessity' cannot either constitute a binding adjudication upon any antitrust issues that may be involved in the Commission's proceeding or serve to exempt a licensee *pro tanto* from the antitrust laws, and that these considerations alone are dispositive of this appeal." *Id.,* at 353.

In *California* v. *Federal Power Commission,* 369 U. S. 482 (1962), the question was whether the authority in the Federal Power Commission to approve mergers in the public interest foreclosed antitrust challenge to an approved merger. The Court held that agency approval did not confer immunity from § 7 of the Clayton Act, even though the agency had taken the competitive factors into account in passing upon the application. A year later, in *United States* v. *Philadelphia Bank, supra,* the Court rejected the contention that "the Bank Merger Act, by directing the banking agencies to consider competitive factors before approving mergers . . ,

immunizes approved mergers from challenge under the antitrust laws." 374 U. S., at 350 (footnote omitted). More recently, we applied this principle in *Otter Tail Power Co. v. United States,* 410 U. S. 366 (1973). There the Court held that the authority of the Federal Power Commission to order interconnections between power systems of two companies did not exempt company refusal to interconnect from antitrust attack.

Under these and other cases it could not be clearer that "[a]ctivities which come under the jurisdiction of a regulatory agency nevertheless may be subject to scrutiny under the antitrust laws," *id.,* at 372, and that agency approval of particular transactions does not itself confer antitrust immunity.

The foregoing were the governing principles both before and after *Silver* v. *New York Stock Exchange,* 373 U. S. 341 (1963). There, stock exchange members were directed to discontinue private wire service to two nonmember broker-dealers, who were given no notice or opportunity to be heard on the discontinuance. The latter brought suit under §§ 1 and 2 of the Sherman Act, but the Court of Appeals held that the stock exchanges had been exempted from the antitrust laws by the Securities Exchange Act of 1934. This Court reversed. The Act contained no express immunity, and immunity would be implied "only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." 373 U. S., at 357. Conceding that there would be instances of permissible self-regulation which otherwise would violate the antitrust laws, the Court concluded that nothing in the Act required that the deprivations there imposed be immune from the antitrust laws. In arriving at this conclusion, it was noted that the Securities and Exchange Commission had no authority to review specific instances of enforcement of the exchange

rules involved and that it was therefore unnecessary to consider any problem of conflict or coextensiveness with the agency's regulatory power. The Court observed, however, that if there had been jurisdiction in the Commission, with judicial review following, "a different case would arise concerning exemption from the operation of laws designed to prevent anticompetitive activity . . . ." *Id.*, at 358 n. 12.

Such a different case, we said, was before us in *Ricci* v. *Chicago Mercantile Exchange*, 409 U. S. 289, 302 (1973). That case arose in the context of the Commodity Exchange Act. We held that a district court entertaining a private antitrust action should stay its hand while the Commodity Exchange Commission exercised whatever jurisdiction it might have to adjudicate specific claims of violation of exchange rules; but that adjudication, we said, was not a substitute for antitrust enforcement, and the fact that the Commission had jurisdiction to approve or disapprove the challenged conduct and might hold the conduct to be consistent with exchange rules would not, in itself, answer the immunity question. 409 U. S., at 302–303 n. 13.

On occasion, however, Congress has authorized an agency to adjudicate the legality of specifically defined transactions or commercial behavior in accordance with a competitive standard inconsistent with the controlling criteria under the antitrust laws. In these circumstances, the Court has concluded that Congress intended to replace normal antitrust enforcement with the administrative regime provided by the statute, subject to judicial review. *Pan American World Airways, Inc.* v. *United States*, 371 U. S. 296 (1963), involved certain business conduct within the jurisdiction of the Civil Aeronautics Board. Under the Federal Aviation Act, various transactions by air carriers, if approved by the Board, were expressly

immunized from antitrust attack. Also, the Board was given explicit authority under § 411 of that Act, 49 U. S. C. § 1381, to investigate and bring to a halt all "unfair practices" and "unfair methods of competition," the power under this section to be administered in the light of the "competitive regime" clearly delineated elsewhere in the Act. See 371 U. S., at 308–309. The Court concluded that Congress, having directed itself to the matter of competition in the airlines industry and having provided a competitive standard to be administered by an agency, had intended to displace the usual enforcement of the antitrust laws through the courts, at least insofar as government injunction suits were concerned. *United States* v. *Philadelphia National Bank, supra,* made it plain that *Pan American* had not disturbed the usual rule that, without more, agency power to approve, and agency approval itself, does not confer antitrust immunity. 374 U. S., at 351–352.

Gordon v. *New York Stock Exchange, Inc.,* — U. S. — (1975), decided today, is another instance where Congress has provided an administrative substitute for antitrust enforcement. Section 19 (b) of the Securities Exchange Act contemplated the fixing by the Exchange, and approval or prescription by the Securities and Exchange Commission, of "reasonable rates of commission" to be charged by Exchange members. Price fixing by competitors, however, is wholly at odds with the Sherman Act; under that statute prices fixed by agreement are inherently unreasonable, whatever the level at which they are set. This was the law long prior to the Securities Exchange Act:

> "The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control

> the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed. Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions." *United States* v. *Trenton Potteries Co.,* 273 U. S. 392, 397–398 (1927).

Thus Congress could not have anticipated that the antitrust laws would apply to stock exchange price fixing approved by the Commission. In this respect, there is a "plain repugnancy between the antitrust laws and regulatory provisions," *United States* v. *Philadelphia National Bank, supra,* at 351 (footnote omitted).

The rule of law that should be applied in this case, therefore, as it comes to us from these precedents, is that, absent an express antitrust immunization conferred by Congress in a statute, such an immunity can be implied only if Congress has clearly supplanted the antitrust laws and their model of competition with a differing competitive regime, defined by particularized competitive standards and enforced by an administrative agency, and has thereby purged an otherwise obvious antitrust violation of its illegality. When viewed in the light of this rule of law, the argument for implied immunity in this case becomes demonstrably untenable.

II

Section 22 (f) of the Investment Company Act provides that "[n]o registered open-end investment company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company." The majority concludes from these words and their sparse legislative history that the "funds and the SEC" have the authority to impose "SEC-approved restrictions on transferability and negotiability," *ante,* at 28, including the restrictions involved here effecting resale price maintenance and concerted refusals to deal, all aimed at stifling competition that might come from the secondary market. The majority concludes that "[t]here can be no reconciliation of [SEC] authority . . . to permit these and similar restrictive agreements . . ." with their illegality under the Sherman Act and that therefore "the antitrust laws must give way if the regulatory scheme established by the Investment Company Act is to work." *Id.,* at 33.

For several reasons, the majority's conclusions are infirm under the controlling authorities. It is plain that the Act itself contains no express exemptions from the antitrust laws. It is equally plain that the Act does not expressly permit the specific restrictions at issue here in the way that it deals with the public offering price under § 22 (d). It would be incredible even to suggest that Congress intended to give participants in the mutual fund industry, individually or collectively, *carte blanche* authority to impose whatever restrictions were thought desirable and without regard for the policies of the antitrust laws. The majority does not contend otherwise

and rests its case on the power which it finds in the Commission to approve, or to fail to disapprove, the practices challenged here and to immunize them from antirust scrutiny.

It is immediately obvious that the majority has failed to heed the teaching of our cases in several respects. It ignores the rule that "exemptions from the antitrust laws are strictly construed" and that implied exemptions are "strongly disfavored." *Federal Maritime Commission* v. *Seatrain Lines, Inc., supra,* 411 U. S., at 733. Lurking in the *prohibition* of § 22 (f) against any restrictions on "transferability or negotiability" except those stated in the registration statement, the Court discovers the affirmative power to impose resale price maintenance restrictions, as well as the authority to engage in concerted refusals to deal and similar practices wholly at odds with the antitrust laws. Never before has the Court labored to find hidden immunities from the antitrust laws; and the necessity for the effort is itself at odds with our precedents.

The Court's holding that Commission approval automatically brings with it antitrust immunity is also contrary to those cases which have consistently refused to equate agency power to approve conduct with an exemption under the antitrust laws. Those cases, as demonstrated above, uniformly held that actual agency approval of the very transaction which the statute empowers the agency to approve is not in itself sufficient to exempt the transaction from liability under the Sherman Act, absent express exemption, or its equivalent, under the regulatory statute itself. This is true even where the agency is required to take antitrust considerations into account in approving the transaction or agreement and, *a fortiori,* where there is no evidence that such factors played any part in agency approval.

Here, the Court finds authority in open-end funds, subject to Commission approval, to impose restrictions on "negotiability and transferability," construes those words generously to include price fixing and concerted boycotts, and then concludes that Commission approval—rather, its failure to disapprove—automatically and without more confers antitrust immunity on the selling practices followed by the particular open-end funds in this case. This result disregards the fact that there is no express provision for immunity in the statute, no direction to the Commission to consider competitive factors, no statutory standard provided for the Commission to follow with respect to competition in the investment company business, no indication that the Commission has considered the competitive impact of the restrictions at issue here, and no other basis for concluding that Congress intended the unilateral business judgment of an investment company, followed by Commission approval, to substitute for and supplant the antitrust laws.

The position of the Securities and Exchange Commission, as described and embraced by the Court, is that "its authority will be compromised" if industry practices which the Commission has the power to approve are subject to scrutiny under the antitrust laws. See *ante*, at 33. But the Commission has made no effort to analyze and explain the need for these seriously anticompetitive restrictions in the mutual-fund industry. It has never affirmatively and formally approved the specific practices involved in this case, by rule or adjudication. Until recently, it has seemingly left investors and the public to the tender mercies of the industry itself. In fashioning antitrust immunity for these practices, the majority acts in complete disregard of the basic approach mandated by our cases, including the principles approved by the

unanimous Court in *Federal Maritime Commission* v. *Seatrain Lines, Inc., supra:*

> "The Commission vigorously argues that such agreements can be interpreted as falling within the third category—which concerns agreements 'controlling, regulating, preventing, or destroying competition.' Without more, we might be inclined to agree that many merger agreements probably fit within this category. But a broad reading of the third category would conflict with our frequently expressed view that exemptions from antitrust laws are strictly construed, see, *e. g., United States* v. *McKesson & Robbins, Inc.,* 351 U. S. 305, 316 (1956), and that '[r]epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions.' *United States* v. *Philadelphia National Bank,* 374 U. S. 321, 350–351 (1963) (footnotes omitted). As we observed only recently: 'When . . . relationships are governed in the first instance by business judgment and not regulatory coercion, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws.' *Otter Tail Power Co.* v. *United States,* 410 U. S. 366, 374 (1973). See also *Silver* v. *New York Stock Exchange,* 373 U. S. 341 (1963); *Pan American World Airways, Inc.* v. *United States,* 371 U. S. 296 (1963); *California* v. *FPC,* 369 U. S. 482 (1962); *United States* v. *Borden Co.,* 308 U. S. 188 (1939). This principle has led us to construe the Shipping Act as conferring only a 'limited antitrust exemption' in light of the fact that 'antitrust laws represent a fundamental national economic policy.' *Carnation Co.* v. *Pacific*

Westbound Conference, 383 U. S., at 219, 218." 411 U. S., at 732–733 (footnotes omitted).

III

Exempting the NASD from antitrust scrutiny based on the existence of Commission power to approve or disapprove NASD rules is likewise unacceptable under our cases for very similar reasons. The majority relies on *Hughes Tool Co.* v. *Trans World Airlines, supra,* and *Pan American World Airways, Inc.* v. *United States, supra.* But in *Hughes* exemption for the transactions there involved was based on the express immunities conferred by § 414 of the Federal Aviation Act; and in *Pan American* immunity followed from the Board's authority to adjudicate unfair competitive practices in accordance with the distinctive competitive standard Congress itself supplied in the regulatory statute. Nothing comparable is to be found in the relevant provisions of the statutes involved here.

It is especially interesting to find the Court on the one hand concluding that the selling practices under scrutiny here are essential to the working of the statutory scheme but on the other hand recognizing that the Commission itself has requested that the NASD rules be amended to prohibit agreements between underwriters and broker-dealers that preclude broker-dealers, acting as agents, from matching orders to buy and sell fund shares in a secondary market at competitively determined prices and commission rates. *Ante,* at 22 n. 31.

The majority's opinion, as a whole, seems to me to reject the basic position found in our cases that "antitrust laws represent a fundamental national economic policy. . . ." *Carnation Co.* v. *Pacific Westbound Conference,* 383 U. S. 213, 218 (1966). I cannot follow that course and accordingly dissent.